CANFOR

# Canfor Corporation 1986 Annual Report

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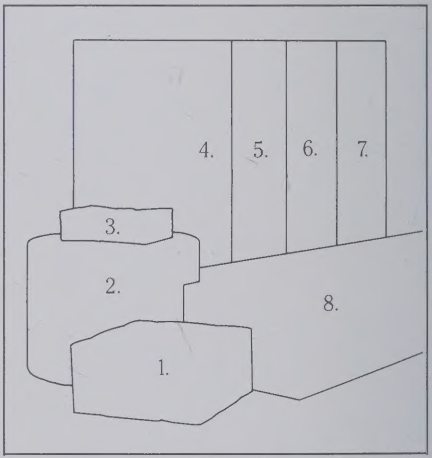
## Our Commitment

We are committed to safety and job satisfaction for our employees, product quality and service for our customers and profits for our shareholders.

COVER PHOTO:
*A selection of Canfor products.*




*1. Bale of fully bleached kraft pulp*
*2. Roll of sack kraft paper*
*3. Bundle of shingles*
*4. Buckingham hardboard wall panel*
*5. Spruce exterior plywood sheathing*
*6. Chalet exterior plywood panel*
*7. Aeroboard hardboard panel*
*8. A selection of lumber*

## Financial highlights

| | 1986 | 1985 |
|---|---|---|
| **Sales and income** *(in millions of dollars)* | | |
| Net sales | $1,046.8 | $1,083.8 |
| Income (loss) before equity income and minority interest | 27.2 | (54.0) |
| Net income (loss) | 23.7 | (61.4) |
| Cash flow from operations | 111.8 | 0.8 |
| **Per common share** *(in dollars)* | | |
| Net income (loss) | $ 0.81 | $ (3.67) |
| Cash flow from (used in) operations | 5.01 | (0.32) |
| Common shareholders' equity | 12.20 | 11.08 |
| **Financial position** *(in millions of dollars)* | | |
| Working capital | $ 61.7 | $ 1.3 |
| Total assets | 817.0 | 914.8 |
| Long-term liabilities | 186.2 | 198.8 |
| Shareholders' equity | 359.2 | 292.0 |
| Total capitalization | 587.4 | 519.5 |
| **Additional information** | | |
| Return on capital employed | 5.5% | (5.5)% |
| Return on common shareholders' equity | 7.1% | (28.5)% |
| Ratio of current assets to current liabilities | 1.3:1 | 1.0:1 |
| Ratio of total debt to shareholders' equity | 43:57 | 60:40 |
| Capital expenditures *(in millions of dollars)* | $ 37.9 | $ 63.6 |
| Number of employees at year end | 5,293 | 6,260 |
| Employment costs *(in millions of dollars)* | $ 206.5 | $ 270.6 |

## Quarterly financial information

| | 1986 Three months ended | | | | 1985 Three months ended | | | |
|---|---|---|---|---|---|---|---|---|
| | *Mar 31* | *June 30* | *Sept 30* | *Dec 31* | *Mar 31* | *June 30* | *Sept 30* | *Dec 31* |
| **Sales and income** *(in millions of dollars)* | | | | | | | | |
| Net sales | $271.7 | $288.8 | $284.5 | $201.8 | $248.5 | $307.4 | $276.3 | $251.6 |
| Income (loss) before equity income and minority interest | 1.3 | 10.6 | 11.0 | 4.3 | (17.0) | (7.2) | (13.5) | (16.3) |
| Net income (loss) | 2.2 | 11.2 | 12.5 | (2.2)* | (16.6) | (8.6) | (14.0) | (22.2) |
| **Per common share** *(in dollars)* | | | | | | | | |
| Net income (loss) | 0.02 | 0.48 | 0.51 | (0.20)* | (0.99) | (0.56) | (0.83) | (1.29) |

**After write-down of investment in Versatile Corporation.*

*For definitions of selected financial terms, please refer to page 45.*

# Directors' report to shareholders

## EXECUTIVE REVIEW

### Summary of 1986

Following four difficult years of losses, Canfor returned to meaningful profitability in 1986. The turnaround resulted from numerous actions to reduce costs and debt, as well as from increased productivity, strong employee involvement and better markets for pulp and paper.

Net income for the twelve months ended December 31, 1986, was $32.0 million, or $1.21 per common share after provision for dividends on preferred shares, before an $8.3 million write-down of the shares in Versatile Corporation held by Canfor in connection with its exchangeable preferred share issue. Before the write-down, 1986 earnings represented an improvement of over $93 million from the 1985 loss of $61.4 million or $3.67 per common share after preferred dividends. After the write-down of the Versatile shares, net income for 1986 was $23.7 million or $.81 per share after preferred dividends.

Net sales of $1,046.8 million for 1986 represented a slight decrease from the previous year's level of $1,083.8 million, reflecting a strike by the International Woodworkers of America in the second half of the year and the closure or divestiture of certain operations during late 1985 and 1986.

The strike closed the majority of the Company's


*Ed Davies, Machine Operator, maintains a close watch on the computerized, mill wide information network that plays a vital role in the quality control program at the Howe Sound Pulp Division.*


*From her control booth, Shirley Durau, Chip-N-Saw Operator at the Chetwynd Division, ensures the computerized machine settings provide optimum lumber recovery.*

wood products operations in British Columbia for four and one-half months and its Howe Sound Pulp mill for six weeks. The closures are estimated to have reduced the Company's 1986 operating results by more than $30 million. This action by the I.W.A. imposed hardships on employees and customers, and represented an unfortunate contrast to the constructive pulp and paper negotiations earlier in the year, which led to a new two-year agreement without disruption of operations.

The year's operating results were also affected by downtime required to reduce inventories at all of the Company's pulp and paper operations. The downtime allowed extensive maintenance and repair work to proceed during 1986, including a 35 day recovery boiler rebuild at the Prince George Pulp mill in the last quarter. As a result, mill curtailments for maintenance in 1987 will be minimal.

During 1986, excellent results were achieved throughout Canfor's marketing, manufacturing and logging operations. Further improvements were made in product quality and customer service, and many production records were set. Combined with previously implemented reductions in employment and expenses, the production gains contributed significantly to profitability.

Pulp markets experienced a major recovery during 1986. In response to strengthening demand for paper and board products, worldwide producer inventories of pulp declined steadily, reaching very low levels by year end. Together with the weakening of the United States' dollar relative to the European and Japanese currencies, these factors led to significant pulp price increases over the course of the year.

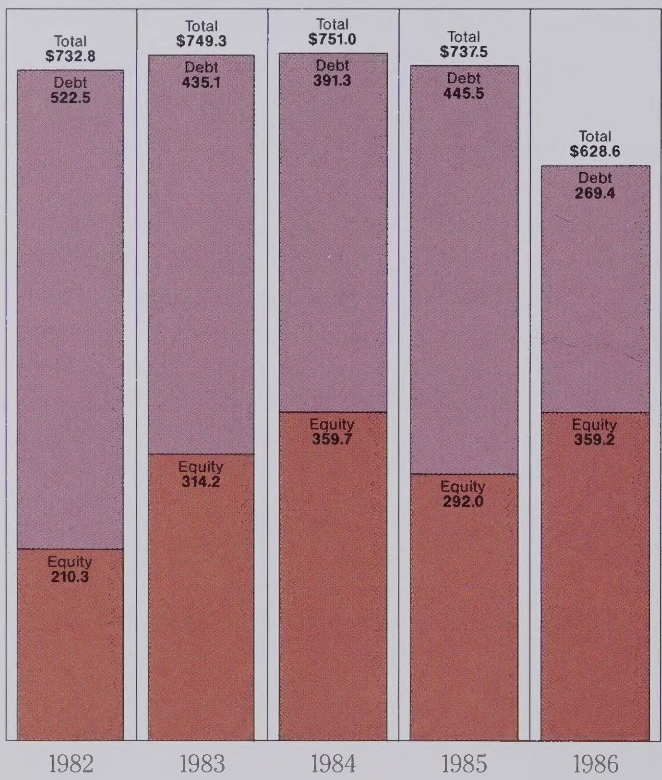
The market for sack kraft paper firmed during 1986, reflecting industry restructuring in the United States, which reduced total production capacity, as well as the foreign exchange factors noted above.

The Company's United States' lumber market was better during 1986 as a whole, but continuing excess supply kept prices below satisfactory levels for most of the first half of the year. During the second half, the market was extremely volatile, reflecting uncertainties created by the United States' countervailing duty proceedings and the I.W.A. strike in British Columbia. Although lumber prices were higher on average during this period, the Company benefitted only at its Alberta operations, which were unaffected by the strike.

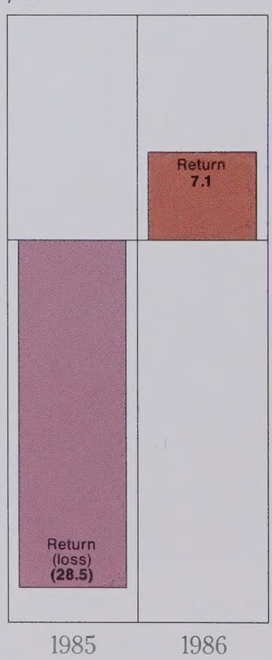
Offshore lumber markets improved during 1986, particularly over the latter part of the year, as a result of increased demand and the strength of the Japanese and European currencies.

In Canada, a strong housing industry in 1986 contributed to a very buoyant market for plywood and to gains for Canfor's domestic building materials distribution business. Canfor U.S.A. Corporation, the

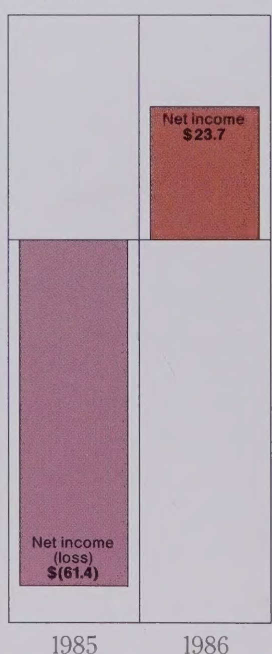
Debt and equity
*$ millions*




Return on common shareholders' equity
*per cent*




Net income (loss)
*$ millions*




Company's distribution subsidiary in the United States, experienced a difficult year and action has been taken to improve its results.

Canfor's financial position strengthened substantially during 1986 as a result of the sale of additional common shares of the Company together with tax credits, cash flow from the oil and gas working interests, the sale by the Company of its shares in Balco Industries Ltd., and particularly the much greater cash generation from operations. These factors contributed to a debt reduction of approximately $180 million during 1986 and to a much improved debt to equity ratio at year end.

Capital spending during 1986 totalled $37.9 million, down from the 1985 figure of $63.6 million, in keeping with the priority placed on debt reduction. However, necessary modernization and replacement projects proceeded as required and numerous high return internal opportunities were undertaken. Much of this spending was directed toward the pulp and paper mills to ensure that these operations would be able to take advantage of the anticipated market improvements.

## Executive and board changes

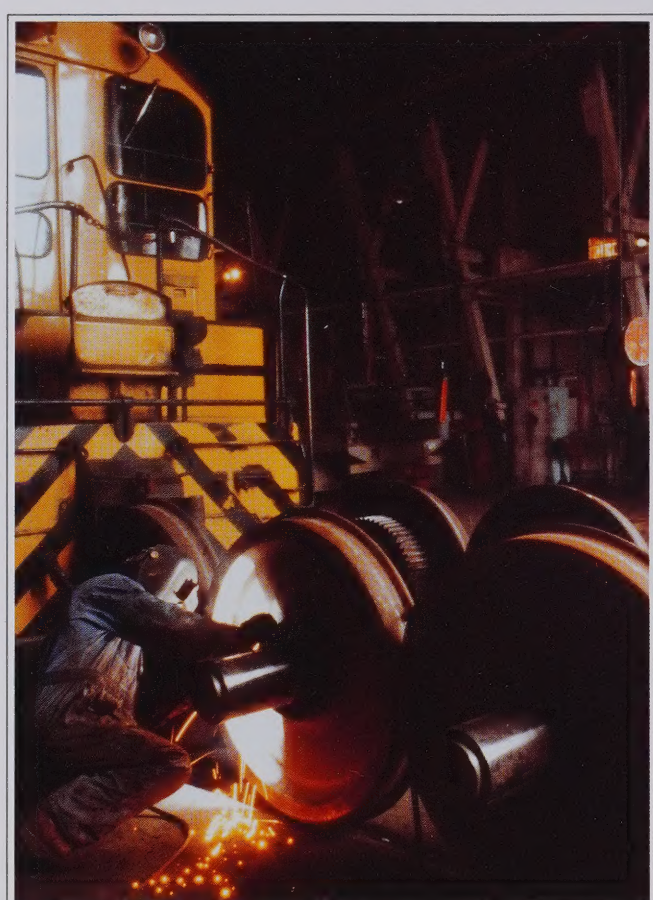
In mid-February 1987, Canfor was deeply saddened by the loss of John G. Prentice, a director of the Company and one of its founders. Mr. Prentice, who was 79, had served as Chairman of the Company until 1985. His wisdom, judgement and entrepreneurship were instrumental in the growth and development of Canfor.

At the annual general meeting in April 1987, shareholders will be asked to elect a board consisting of twelve directors. In addition to the present incumbents, the nominees include Ronald T. Riley, President and Chief Executive Officer, Calvin Bullock, Ltd.; Barbara R. Hislop, Wood Products Administrator for the Company, and Marietta E. Hurst. The latter two are members of the Prentice-Bentley family and succeed the two founders of the Company on the board.

During 1986, several changes occurred in the executives of the Company. J. Derek Falck was

appointed Vice-President, Corporate Services, succeeding James D. Earle who undertook senior management responsibilities in coastal operations, and Peter J. Ashby joined the Company as Vice-President, Wood Products Marketing, Sales and Transportation. The latter appointment, together with other senior management changes in the wood products and pulp and paper marketing organizations, represents important progress in further strengthening Canfor's marketing around the world.

*The operator of the 30 ton portal crane at Grande Prarie Lumber Division gets a bird's-eye view of the logging truck being unloaded.*



*Steve Zima, Welder, works on a locomotive wheel at Englewood where Canfor operates a full gauge railroad.*

## Outlook for 1987

As a result of the strong market outlook for Canfor's pulp and paper products, a substantial increase in earnings is anticipated for 1987. Based on the very favorable price and volume prospects for these products, the Company expects to operate its pulp and paper mills at close to full capacity in 1987 for the first time in many years.

The 1987 outlook for wood products is less buoyant but still favorable. Panelboard markets are expected to be satisfactory and offshore lumber markets should improve relative to 1986.

The United States lumber market has stabilized following conversion of the interim countervailing duty to a 15 per cent Canadian federal export charge, and prices have strengthened in response to healthy demand. However, this positive short-term outlook must be weighed against the underlying excess supply of lumber and the extra cost imposed on Canadian lumber producers by the export charge.

Building materials distribution results are anticipated to improve during 1987, reflecting further gains in Canada and a turnaround by Canfor U.S.A.

The Company will continue to benefit during 1987 from the cost reductions implemented over the past two years, as well as from the positive market factors. The expected increase in cash flow from operations will be applied to continued debt reduction and to appropriate capital expenditures aimed at further enhancing the profitability of the Company's principal lumber and pulp and paper businesses. As well, collective agreements are in place covering the majority of unionized employees through mid-1988, helping to assure uninterrupted operations during 1987.

In conclusion, the efforts and achievements of the employees who contributed to the much improved performance in 1986 are recognized. Also, the support of Canfor's shareholders during the recent difficult years is acknowledged. Now that the Company has regained its financial health, we look forward to the future with confidence.

On behalf of the directors,

Peter J. G. Bentley
*Chairman and Chief Executive Officer*

*March 6, 1987*
*Vancouver, British Columbia*

## A tribute to our founders

The passing of John G. Prentice in February 1987, almost exactly a year after the death of L. L. G. "Poldi" Bentley, his brother-in-law and longtime business partner, marked the end of an era for our Company. The loss of Canfor's two founders is particularly sad at this time because they did not live to enjoy their Company's strong recovery. Nor will they take part in celebrating Canfor's fiftieth anniversary next year.

The Company they founded has become one of Canada's major forest industry complexes, thanks in large measure to their business acumen and vision. They were proud of what they had achieved and proud of the people who helped them build the Company. Similarly, many of our employees remember them with great admiration and fondness.

Both men were born and raised in Vienna, Austria. They came to Canada in 1938 and opened a furniture veneer plant in New Westminster called Pacific Veneer which employed just 28 people. The company became Canadian Forest Products Ltd. in 1944. Mr. Prentice became President, then Chairman of the Board, while Mr. Bentley became Vice-President, President, then Vice-Chairman. They retired in April 1985.

During their long and productive working careers both men achieved a great deal, as builders of our Company, as forest industry statesmen and as leaders in their communities.

Mr. Prentice was the driving force behind Canfor's wholesale building materials organization, which is one of the most successful in the industry and serves Canada from coast to coast.

Outside the company, his contributions to business and community groups are too numerous to list. Among them were directorships in the Bank of Montreal, Canadian Broadcasting Corporation and the Conference Board of Canada. In addition to being a sports enthusiast, he was also an active supporter of the arts and served as chairman of the Canada Council for five years. Known worldwide as an avid chess player, he served as president of the Chess Federation of Canada for 16 years and was the non-playing captain of Canada's team in the Chess Olympics. For his many contributions to society, Mr. Prentice was appointed an Officer of the Order of Canada in 1977.

*John G. Prentice*

*L. L. G. "Poldi" Bentley*

Mr. Bentley helped make history in the 1960s as a key player in the creation of a pulp and paper industry for British Columbia's interior. The opening of Prince George Pulp and Paper Limited in 1966 heralded a new era of economic growth in the region. He also helped establish the Council of Forest Industries of B.C., one of the most influential industry groups in western Canada. He served as chairman of Seaboard for an unprecedented 11 years. In private life, he loved photography, sports, hunting and the outdoors.

Mr. Bentley was inducted into the Canadian Business Hall of Fame in 1982 by Junior Achievement of Canada, and received an honorary Doctor of Laws degree from the University of British Columbia in 1984. A few months after his death, a new chair at the U.B.C. Faculty of Forestry was named in his honor.

John Prentice and Poldi Bentley made a great contribution to their industry and their community. We are dedicated to building on the sound base and reputation that is their legacy.

# Canfor's marketing: Quality products, personal service and lasting partnerships

Our performance in world markets is vital to our success.

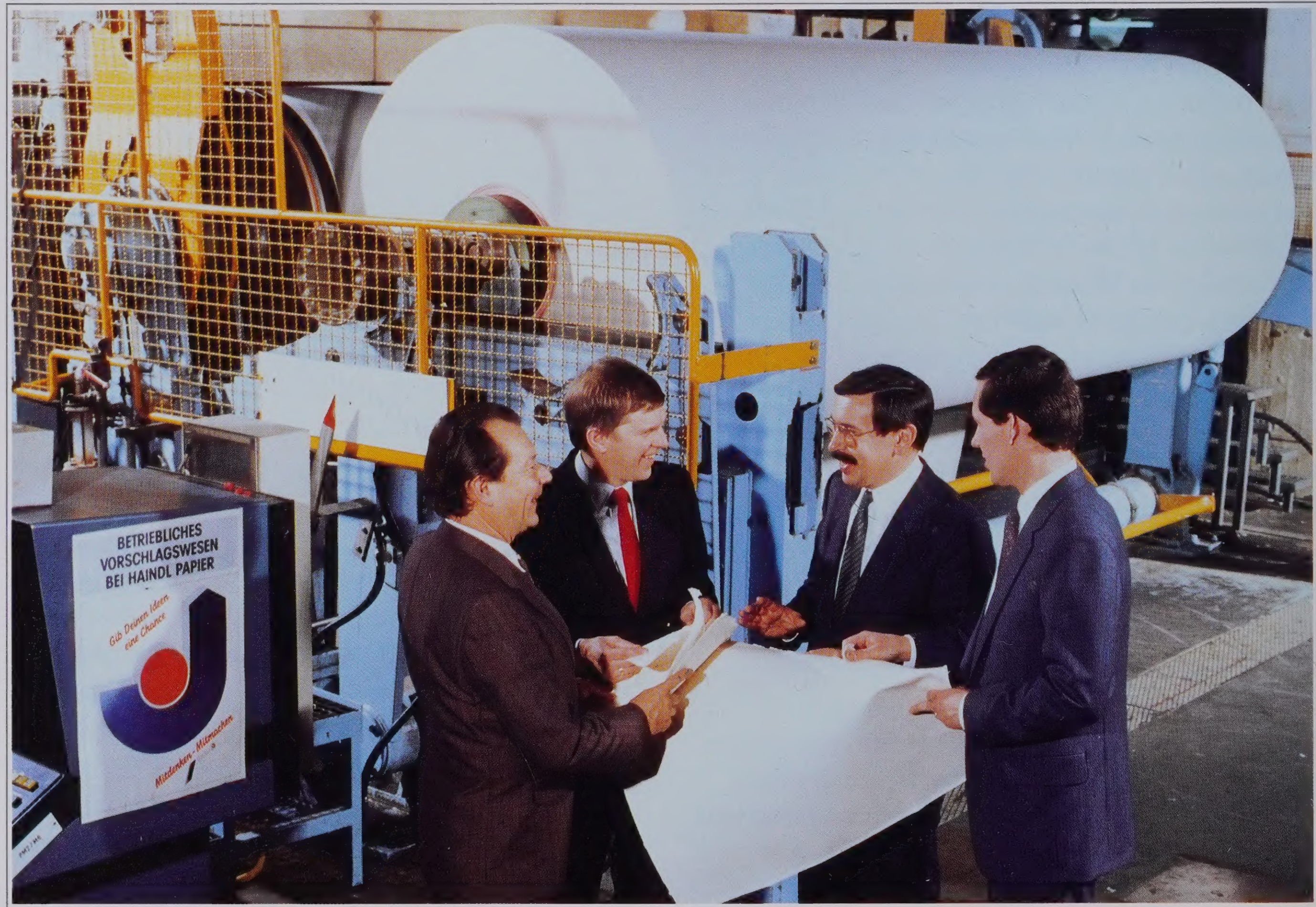
Understanding supply and demand for our products is important but it is only a beginning. The marketplace consists of many individual customers, each with specific needs for products and services. It is our business to know and satisfy those needs better and more consistently than our competitors.

We relate to our customers not as institutions but personally, as individuals. To be close to them, our teams of sales, production, transportation, research and technical people, as well as senior executives, are in the field regularly. They establish solid and lasting partnerships while building customer confidence in our Company.

Through marketing and research, we are also increasing our volume of value-added products. We are quick to seize new opportunities that will increase the return to the Company while filling a customer's need. Their success is our success.

Canfor is meeting the challenge of changes in world markets by being increasingly more customer, quality and cost oriented. We have come a long way on these priorities in a short time while remaining true to the principles and values on which Canfor's reputation has been built.

The highlights of this success appear on the following pages.




*Haindl Papier GmbH of Germany is one of the many producers of quality papers around the world that uses Canfor pulp in its products. Discussing a sheet during a mill visit (left to right) are Walter Baumgartner, Manager of Research and Development of Haindl, Mats Strandberg, a regional General Manager with Canadian Forest Products S.A., Brussels, Peter Winkler, Purchasing Manager of Haindl, and Christer Arnesen, Senior Vice-President, Canfor Pulp Sales, Head Office, Vancouver.*

## Pulp and paper

For Canfor's pulp and paper group, marketing means forming lasting partnerships with our customers all over the world. We work closely with them to determine their requirements, then tailor our production, transportation systems and sales service to meet those needs.

"We are keenly interested in what our customers produce because we want to help them make the best possible product," says Christer Arnesen, Senior Vice-President, Canfor Pulp Sales. "Our Technical Sales Director and key mill people visit our customers worldwide to work with them to achieve the best possible results."

With this approach, great emphasis is placed on the quality and technical properties of our products. Canfor's three mills have been substantially improved over the past few years and now produce pulps and kraft papers that are specifically designed for our customers.

The human element is essential to quality control and the people at all three mills are committed to excellence in product quality and customer service. By displaying our customer's products at the mills, we show our employees how the products they make are used, and demonstrate to them that they are making pulp and paper for a specific customer's needs. With this message, employee interest in product quality is high.

The mills' production of pulp and sack kraft paper is marketed worldwide by Canfor Pulp Sales. "To provide the best level of service, we operate our own offices in Vancouver, Montreal, Tokyo, Brussels, London and, later this year, Hong Kong," says Ron Holton, Marketing Manager, adding, "We are unique in this regard." In other centres, the Company is represented by agents, some of whom have been working with Canfor for over 25 years.

Canfor's marketing representatives are highly qualified professionals. Their extensive knowledge of our products and their applications is a prerequisite to maintaining a close working relationship with customers in their market area. They are our direct link between each customer and our mills.

"We manufacture a variety of pulps with a wide range of characteristics," explains Ron Wilson, Vice-President, Pulp Sales. "Of course, it's very important that our customer use the pulp best suited for his manufacturing facilities and end products. But we go far beyond that matching process. When Howe Sound pulp was rebuilt, we worked closely with our manufacturing people and our customers to ensure the new mill could blend pulps to meet very specific needs."


*Nigel Holland, Manager, Canadian Forest Products (Overseas) Limited of London (left), discusses the end use of Canfor kraft paper with Richard Simes, Plant Manager, Blue Circle Sacks of the United Kingdom.*


*During a visit to a customer's paper mill in Japan, Canfor representatives pause with their hosts beside bales of Prince George pulp which have characteristics ideally suited for the customer's specialty papers. The group (left to right): Fred Mori, Vice-President and General Manager, and Ayako Oka, Administrative Assistant, both of Canfor Japan Corporation; Shoichi Toshiro, Director and Mill Manager, Kumagaya Mill, and Akio Shimonabe, Manager, Purchasing Department, Head Office, both of Shikoku Paper Mfg. Co. Ltd.*

Fraser Evans, General Sales Manager, Pulp, spends much of his time marketing the Howe Sound products. "These new pulps are not commodity products—they are custom made to exacting standards. And we take a very active part in helping the customer determine exactly what blend he needs. Our customers' response to this service is excellent."

Our marketing representatives are also sensitive to economic and political developments in the various world markets and are quick to identify opportunities as they arise.

"We remain alert for market opportunities in terms of both new geographic areas and new products," explains Ron Godfrey, General Sales Manager, Paper. "For example, when there was a major change in the domestic supply of sack kraft in the United States which left a shortage of high quality product, we recognized the opportunity immediately and established ourselves successfully in the market. And when the grocery bag market started to decline due to inroads by plastic bags, we shifted some of our capacity to specialty products such as laminating grades. The result is, we are selling more tonnage than ever before."

*During a customer visit to Prince George Pulp and Paper, Ron Godfrey, Canfor's General Sales Manager, Paper, shows a protective end cover for a paper roll to Aikichi Sasaki, Director and General Manager Management Planning (centre), and Tetsushi Togashi, Senior Managing Director, both of Showaseitai Kogyo Co., Ltd. of Tokyo, Japan.*

Determining what the customer wants, then providing the best possible matching product, are two parts of the marketing function. Another key element is distribution—getting the product to the customer on time, in prime condition, and at a reasonable freight cost.

Canfor's long term ocean shipping arrangements provide regular, scheduled deliveries of our products to major offshore markets. In the ports of destination, we use carefully selected terminals that specialize in pulp and paper products.

"To serve Canada and the United States, we work closely with railways and trucking companies," says Bob Renwick, Distribution Manager. "In this way, we have developed optimum loading arrangements to minimize freight costs and protect our products in transit to maintain their high quality. Many of our North American shipments go to warehouses strategically located close to our major customers, forming a buffer inventory that allows us to respond quickly to customer orders." The utmost care is taken to ensure our pulp and paper reaches the customer in top condition. The warehouses and carriers with whom we deal are professionals who are well aware of our requirements. We monitor their performance closely, providing assistance and direction. In all cases, our transportation arrangements are carefully co-ordinated with customer requirements.

Our awareness of our customers' needs for quality and service is the basis of our lasting partnerships we have formed with them and the major reason for the success of the pulp and paper marketing group.

## Wood products

The world market for solid wood products is changing and Canfor's marketing approach is changing with it.

"We have a cohesive team of sales, distribution and transportation people working together with manufacturing to focus on customer needs," states Peter Ashby, Vice-President, Wood Products Marketing, Sales and Transportation. "This joint effort and co-ordination of all our people is Canfor's way of marketing."

Our wood products mills are highly market oriented. Each Canfor operation is acutely aware of its mill-to-market match as well as the great importance of providing quality and service while contributing to Canfor's profit.

Our customers are facing a changing market for end users in terms of product quality, size, strength and presentation. The repair and remodelling market segment is one example where demand is growing quickly. We stay a step ahead of these changes, to ensure we offer exactly the right product mix and services to meet our customers' requirements.

Individual marketing relationships are important to Canfor and the Lumber and Shingle Marketing Division (LSMD) provides that crucial link to our customers. "Our role is to foster a partnership of marketing between each customer and our mills," says Jack MacMillan, Vice-President of LSMD. "Each mill has its own sales/production co-ordinator who provides communication between the sales and manufacturing staff to ensure the mill responds promptly to the customer's requirements."

Through our mills and marketing arrangements, we supply our customers worldwide with 1.7 billion board feet of lumber annually.

*Bill King, Canfor's General Marketing Manager, Coast Mills (left), discusses overseas lumber shipments with Herm Klassen, Traffic Manager, at Seaboard International Terminal in North Vancouver.*


*During a marketing trip to Japan, Russ White, LSMD's General Manager Marketing, Interior Mills, and Hank Dressler, Mill Manager of Canfor's Fort St. James Division, tour a secondary manufacturing plant to assess new opportunities in the Japanese market.*


*Jack MacMillan, Vice-President of Canfor's Lumber and Shingle Marketing Division (centre), on one of his regular trips to our customers' operations. Here, he is with Ken Moore, Vice-President, Merchandising, Lowes Companies Inc. (right), and Sam Jennings, Manager, Thomasville Forest Products, North Carolina, a division of Lowes (left).*


*Wayne Jacques, Vice-President, Alberta Operations (left), and Peter Ashby, Vice-President, Wood Products Marketing, Sales and Transportation, examine materials used in marketing Canfor's highly successful finger-joined studs.*


*Arnold Sturgeon, Senior Vice-President, BC Rail (left), and John Trask, Canfor's Vice-President, Wood Products Transportation, examine a railcar loaded with Canfor paper wrapped lumber in BCR's Prince George yard. Our close working relationships with the railroads helps make our transportation service second to none.*

Canfor directs the marketing efforts for its products around the world. North American lumber and shingle sales are managed through LSMD in conjunction with our Building Materials Division (BMD) and Canfor U.S.A. Offshore sales are promoted through Seaboard Lumber Sales Company, a marketing consortium of which we are a member. Seaboard operates worldwide through its offices in the United Kingdom, the United States, Japan, Australia, Holland, France and Germany.

As part of a strong new direction in the Company, our product mix is changing and includes a growing number of value-added items. Several Canfor mills offer precision end trimmed (PET) lumber to customers who place a premium on precise and uniform sizing. Canfor has become a market leader with Grande Prairie Lumber's finger-joined studs which have proven to be vastly superior to regular studs in strength and stability. Eburne produces clear grades of kiln dried hemlock for garage door manufacturers. Other Canfor mills, such as the High Level Division and Canfor U.S.A.'s Cut Plant Division, remanufacture lumber to provide value-added products to select customers.

"The market emphasis is on superior appearance, special sizes, quality and strength," says Wayne Jacques, Vice-President, Alberta Operations, "and we in manufacturing are co-operating with the marketing groups in aggressively pursuing opportunities in all areas."

Changes in transportation have also affected marketing strategy. The deregulation of U.S. railroads has benefitted high-volume shippers such as Canfor. By negotiating rates with the railways, and making greater use of our four strategically placed reload centres, we have improved service to our United

*Ray Shaw, General Marketing Manager, Hardboard and Panel Products (left), discusses hardboard quality control with Jim Earle, Regional General Manager, Coast Wood Products Manufacturing (centre), and Orest Novik, General Manager, New Westminster Hardboard Division.*

*Dr. Suezone Chow, Canfor's Director of Research, Wood Products, developed the finger-joining technique in use at the Grande Prairie mill.*

States' customers without increasing our shipping costs. Sales staff now quote prices on a delivered basis. We work out the shipping arrangements, freeing the customer from that complex task and enabling us to obtain the best freight arrangements possible.

Canfor leads the industry in delivered pricing just as we did when we established our first lumber reload facility in the United States several years ago and when we became the first company in the Canadian forest industry to have its own fleet of leased railcars.

"We are now working on a new delivery concept in which the customer's order arrives just in time to replenish inventory," says John Trask, Vice-President, Wood Products Transportation. "Computerized monitoring gives us tight control of our fleet, allowing us to meet customer delivery dates."

## Building materials distribution

Building materials distribution is a crucial part of our marketing programs. To many of Canada's leading building materials retailers, Canfor is their largest supplier.

A major attraction to our customers is our broad product mix which is unique in the industry. Our Building Materials Division markets all the Company's plywood and hardboard products in Canada and in the United States, and in overseas markets through Seaboard. It also markets a portion of the Company's lumber and shingle production in Canada. To provide our customers with an ever greater range of products and service, we also offer over 60 allied building products lines such as paint, hardware and laminates, some on an exclusive basis in Canada.

Through our 21 Canadian distribution centres we service over 3000 individual customers in hundreds of cities and towns in every region of the nation. Each Distribution Centre is operated like a separate business to satisfy local customers' needs.

"In each Centre, our people are encouraged to display entrepreneurial spirit in pursuing opportunities unique to their local market," says Jake Friesen, Vice-President and General Manager, Building Materials Division. "The result is a high level of personal service to our customers and the formation of strong partnerships."

Our future success in marketing lies in our determination to identify customer needs and market trends and then co-ordinate our response with our mills.

*Jake Friesen, Vice-President and General Manager, Building Materials Division, meets with Barrie Sali, President and General Manager of Tim-BR-marts Ltd., a major BMD customer.*


*Gerard Pettipas, Manager, Moncton Distribution Centre, examines a Weiser Lock display with Frank Tower, Wholesale Sales of Lockhart's Limited in Moncton, New Brunswick. Weiser is one of 60 products distributed in Canada by Canfor.*

## In conclusion

Product quality and service for our customers, and profits for our shareholders are all part of Canfor's commitment, as shown on the inside front cover of this report. We believe strongly that successful marketing and profitability go hand in hand. Our turnaround in 1986 shows we are moving in the right direction.

Our people have successfully risen to the challenge of forming lasting partnerships through innovative marketing. That's the winning Canfor spirit.

# Operations review

## Forestry

Canfor planted 5.8 million seedlings in 1986, a record for the Company's continuing operations, and the total area reforested was 15,000 hectares. Planting levels would have been even greater but an early frost at British Columbia government nurseries on the coast killed many seedlings, reducing the number available for the Company's Tree Farm Licence 37 at Englewood. Additional seedlings have been requested for the current year to make up the shortfall.

Of the seedlings planted by the Company in British Columbia, 28 per cent were grown in the Balco-Canfor Reforestation Centre near Kamloops. In November, a $700,000 expansion project was announced for the Centre to increase its capacity to 6.5 million seedlings annually from the present level of 3.5 million. This project, which is funded jointly by Canfor and Balco, reflects the Company's continuing determination to ensure prompt reforestation of logged lands with high quality seedlings. The British Columbia Ministry of Forests and Lands participates in the on-going operation of the Centre.

Intensive forest management techniques such as juvenile spacing, brushing and weeding, pruning and site rehabilitation were completed on 3400 hectares, down 10 per cent from the previous year's area as a result of the I.W.A. strike.

Canfor's foresters continue to battle insect infestations which can cause serious damage to wood. On the west coast, ambrosia beetle populations have been reduced by a system of baited traps. In the north, a single-tree eradication program is used to combat mountain pine beetles. Their presence is detected early by aerial survey and the affected tree is destroyed before the beetles can spread.

The Company continued to actively support the Province of British Columbia's Integrated Wildlife Intensive Forestry Research Program on northern Vancouver Island. This research is providing information for future logging plans regarding the amount and type of forestland winter range required by deer and elk.

As part of the Salmonid Enhancement Program on the coast, 70,000 chum salmon eggs were

*A forester pollinates seed cones in the Company's genetic improvement program at the Sechelt Seed Orchard.*

collected at McNab Creek. After incubation at the local hatchery, the fry return to the open water. To increase fish population, a new spawning channel was constructed adjacent to the Creek by Canfor and the Department of Fisheries and Oceans.

At Chetwynd, a major milestone was reached with the establishment of an approved Allowable Annual Cut and the submission to the British Columbia Forest Service of the first Management and Working Plan for Tree Farm Licence 48. Once the plan is approved, the Licence itself is awarded.

Alberta's first seed orchard was established in July at Beaverlodge, west of Grande Prairie. Supported jointly by Canfor, Procter & Gamble Inc. and the Alberta Forest Service, this operation will produce about two million genetically-improved seeds per year.

## Harvesting

Productivity at the Company's west coast logging operations was increased during 1986, and despite the 139 day strike by the I.W.A., volumes were 96 per cent of those achieved in 1985. These operations concentrated on reducing costs while maximizing the quality and value of their logs in all phases of production.

*A feller-buncher falls a tree in Canfor's Alberta woodlands operations where a production record was set.*

*Mal Gilette, Faller, bucks a log to specified length at Englewood, the location of Canfor's Tree Farm Licence 37.*

In northern British Columbia, harvested volumes decreased 17 per cent from the previous year. Contributing to this reduction were the strike and a necessary change in Chetwynd's logging plans to salvage timber from an area burned in a major 1985 forest fire.

At the Fort St. James and Isle Pierre Divisions, further cost reductions and efficiency improvements were achieved. Throughout the northern British Columbia operations, logging contractors have been encouraged to adopt multi-axle tractor configurations. This change allows the logging trucks to carry longer logs and larger loads for greater hauling efficiency. The longer logs also improve log deck efficiency at the mills.

In Alberta, which was not affected by the strike, the volume of wood harvested increased nine per cent over the record set in 1984.

The total volume of wood harvested by the Company's continuing operations in 1986 was down by 14 per cent compared with the previous year's level, reflecting the effects of the I.W.A. strike.

## Pulp and paper

The upward trend in demand for market pulp resulted in record shipments of 534,000 tonnes from Canfor's three pulp mills in 1986. However, total production of 516,000 tonnes was up only marginally from the previous year as all mills took some downtime for both inventory reduction and maintenance. In addition, Howe Sound Pulp was forced to close for 44 days in the fourth quarter when its chip supply was cut off by the I.W.A. strike.

Record paper and board production in the world led to extremely low producer inventories of pulp at year end. These factors, along with the rapid depreciation of the U.S. dollar against other major currencies, helped to improve pulp prices by 33 per cent in U.S. dollar terms from the 1985 year end lows.

*Alex McKinnon, Beater Tester at Prince George Pulp and Paper, performs a quality control test to ensure the characteristics of our pulp meet our customer's requirements.*


*Attractive, well marked bales and careful handling are important parts of Canfor's product appearance program. Duaine Yezovich is a member of Prince George Pulp and Paper's skilled workforce.*

For overseas customers, however, prices in terms of local currencies have remained almost constant.

The new pulp machine at Howe Sound Pulp proved its worth in 1986. Aided by increased digester and bleaching capacity, the mill produced a record average daily tonnage for the year and successfully introduced its new line of pulps. In these products, fibers from several coastal wood species are specially blended to match the customer's requirements.

All three mills continued to improve quality and reduce costs. Prince George Pulp and Paper carried out a major recovery boiler rebuild and both Intercontinental and Howe Sound Pulp modified their bleach plants for energy reduction and quality improvement. All mills have important capital projects underway or planned for 1987.

New ocean freight contracts for both pulp and sack kraft were implemented during 1986, resulting in significantly lower transportation costs and improved customer service.

Sack kraft paper production at Prince George increased by nearly 13 per cent in 1986 to 101,000 tonnes, while shipments reached 104,000 tonnes, their highest level since 1978. Sales of extensible grades were especially strong and represented about one-fifth of total shipments.

As a result of restructuring in the United States' kraft paper industry, involving the withdrawal of over half a million tonnes of capacity, the market in North America has strengthened. Prices for sack kraft have been improving in all markets, aided by the appreciation of European and Japanese currencies against the U.S. dollar.

Service to our customers was improved further by the installation of roll wrapping equipment at the Prince George mill and the successful commissioning of new warehousing and transportation facilities in the United Kingdom.

*The Escher Wyss press section in the sack kraft paper machine at Prince George Pulp and Paper is one of the most modern in the industry. The machine produces a variety of high quality papers to meet the needs of Canfor's customers worldwide.*

## Lumber

In 1986, housing starts in the United States reached their highest level in eight years but persistent oversupply prevented lumber prices from attaining the peaks normally associated with such strong building activity. The price for Spruce/Pine/Fir random length 2 x 4 fluctuated from a low of U.S. $152 per thousand board feet in January to a high of U.S. $210 in September when the I.W.A. strike had idled a large portion of the industry in British Columbia.

The announcement in October of an interim 15 per cent countervailing duty on Canadian softwood lumber exports to the United States created uncertainty for American buyers who allowed inventories to decline pending clarification. When the duty became a Canadian-imposed export charge in early 1987, the market stabilized and prices improved with increased demand.

Offshore markets improved significantly during the second half of the year. Improved economic activity in Europe, higher housing starts in Japan and favorable exchange rates led to increased demand and higher prices for the Company's products.

To improve profitability and competitive position in the United States' market, Canfor took the industry lead by negotiating sales on a delivered price basis. This initiative received favorable customer response and resulted in even better utilization of the Company's fleet of over 900 leased railcars.

As a sales agent for Balco, Canfor assisted with the creation of an innovative lumber reload facility. Located in Kamloops, British Columbia, the reload has improved service to Canfor's lumber customers.

In recognition of its "superior advertising, product promotion and attention to customer service," Canfor was the recipient of a prestigious award from the National Home Centre Industry in the United States. It is the first time a Canadian firm has received the award.

Production records were set at many of the Company's lumber operations during the year but the I.W.A. strike in British Columbia reduced 1986 annual volume. Total production from the Company's continuing operations declined by 18 per cent from 1.1 billion board feet in 1985 to just over 900 million in 1986.

At Eburne, the Company's major sawmill on the west coast, daily production rates were increased with even greater concentration on high value material that improved mill net returns substantially.

The northern British Columbia operations achieved record production levels in the first half of the year. Operating costs were reduced and emphasis was placed on value added products such as a select structural grade lumber for the Japanese and United States markets. Improved log yield, increased production and reduced costs are being realized through sawmill improvements at Fort St. John as well as at Fort St. James which is changing from dimension and stud production to dimension only.

The Company's Alberta Operations achieved a record annual volume of 406 million board feet, compared with the 1985 level of 392 million. The High Level mill, in particular, continued to set records and the small log line ran three shifts per day for several months to optimize log use. This mill is installing linear positioners on two lines to increase throughput and sawing accuracy.

At Grande Prairie, the finger-joined stud mill achieved high levels of production while further improving quality. A major marketing effort is underway to maximize returns from this product which is among the finest of its type available.

*Lumber flows past graders at the Fort St. John Division. Graders throughout the Company play an important role in assuring consistent quality for our customers.*

## Shingles

For the first five months of the year, the oversupply of shingles in the major United States' market persisted, although demand and prices were slowly improving. On May 23, the United States government imposed a 35 per cent tariff on imported cedar shingles and shakes leading to industry-wide curtailments in western Canada and a 44 day closure of Canfor's Huntting-Merritt shingle mill.

By July, improved prices for premium grade products allowed the mill to reopen and produce at capacity on a one shift basis through the last half of the year. Annual production was down by approximately seven per cent to about 109,000 squares.

*As part of its commitment to excellence, Huntting-Merritt has the industry's only company shingle inspector, Paul Beaulieu.*

*Canfor is proud to be the exclusive sales agent for the plywood of Balco Industries Ltd. Mohinder Sangha is a core layer in Balco's Heffley Creek mill.*

## Plywood

A high level of building activity in Canada resulted in a very strong domestic market for the Company's plywood products during 1986.

Canfor's plywood plant in Grande Prairie, Alberta, achieved record mill net returns for its products and production was increased to 68 million square feet (3/8 inch basis). This mill is very successful in upgrading a substantial portion of its production to higher value products such as sanded panels, industrial grade panels and prefinished exterior wall cladding. Other value-added opportunities are being investigated.

## Hardboard

Early in the year, a major marketing program was initiated to expand into the promising United States' and offshore markets. However, this effort was seriously undermined by the lengthy I.W.A. strike which also caused production to be down by 44 per cent to 35 million square feet ($\frac{3}{8}$ inch basis), relative to 1985.

Prior to the strike, mill net returns had been improving as the emphasis was increasingly focussed on higher-profit, prefinished specialty panels and industrial products.

New panelling products are planned and fresh initiatives are underway to regain momentum and re-establish the Company's product lines in the marketplace. These initiatives include 'Headstart', a Canadian advertising program, and 'Coming Back Strong', a successful sales program designed especially for the United States. In addition, promising new opportunities for wood fiber products other than panels are being actively pursued.

*Terry Higgins unitizes a package of hardboard at the New Westminster Hardboard Division.*

## Building materials distribution

During 1986, the Building Materials Division reinforced its position as industry leader, serving every region in Canada through its network of 21 distribution centres.

Operating profits in the Building Materials Division improved in 1986 and return on capital employed increased significantly as well. These gains were partly the result of strong residential construction activity in Canada as housing starts reached their highest level since 1978. The Division substantially increased gross margins through careful product line management, and made efficient use of working capital through excellent inventory turnover and close control of accounts receivable. The sale of some surplus facilities and the rental income from others also had a positive impact.

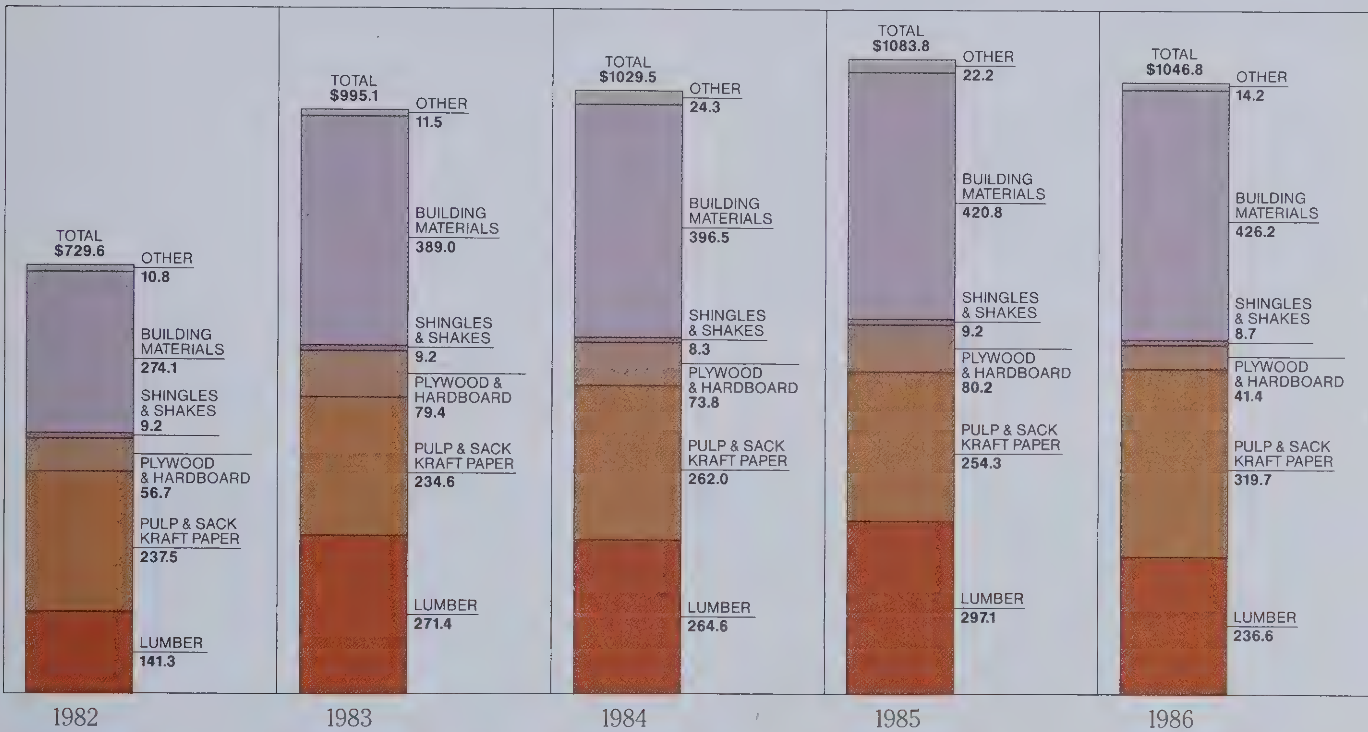
The Division's improved profit performance was achieved despite a slight decrease in sales to $312 million. This reduction resulted from the closure of lumber reloads and the restricted product supply caused by the I.W.A. strike in British Columbia.

Canfor U.S.A. Corporation, the Company's subsidiary in the United States, experienced a difficult year in 1986. Several divisions were sold or closed and sales decreased by 24 per cent. In early 1987, further changes were made in both facilities and organization resulting in a smaller, more efficient operation with much improved profit potential.


*Jim Coan, Production Supervisor, Idaho Division, checks a truckload of paper wrapped lumber.*

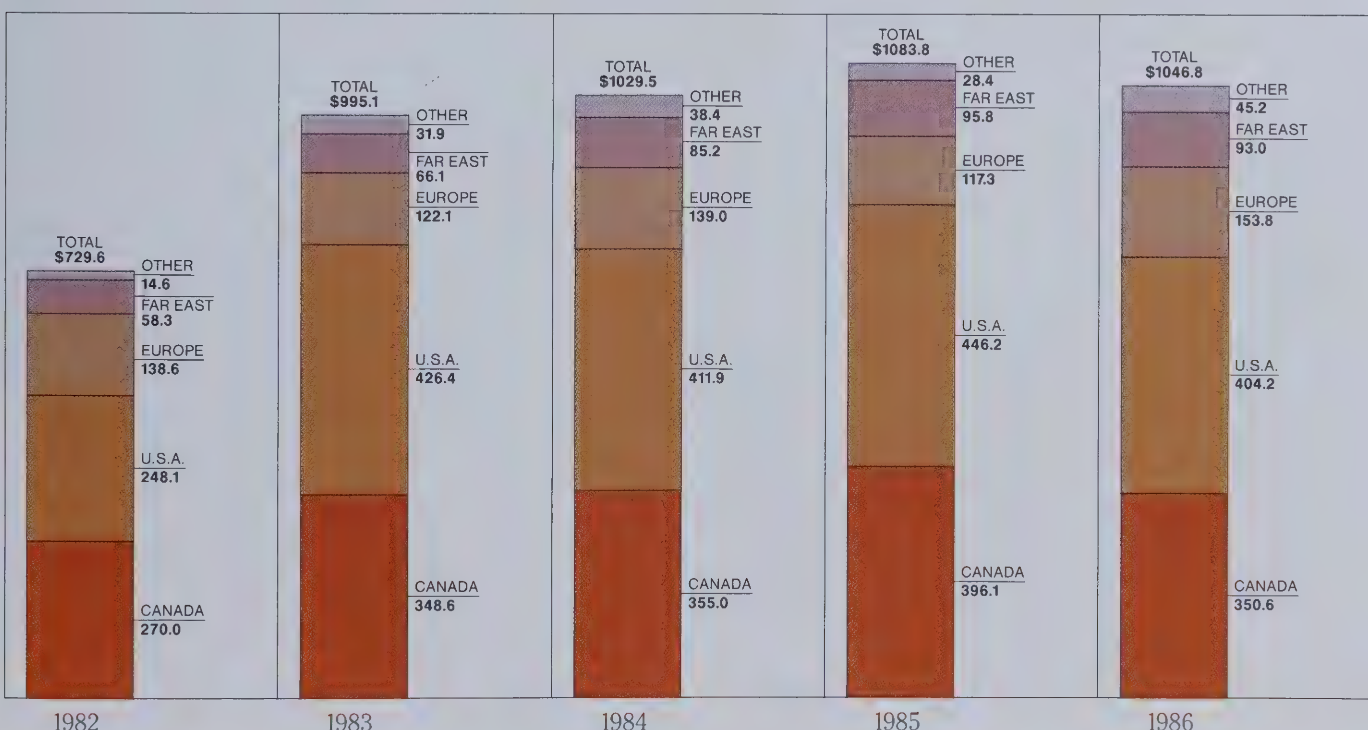
## Sales by product line

*$ millions*




## Sales by market

*$ millions*



## FINANCIAL REVIEW

### Management responsibility

The information and representations in this annual report were prepared by Canfor's management. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in Canada and, where necessary, reflect management's best estimates and judgements. The financial information presented throughout this report is consistent with that contained in the consolidated financial statements.

### Operating results

Operating income of $96.2 million for 1986 showed a turnaround of $119.8 million from the loss of $23.6 million incurred in 1985. The pulp and paper segment contributed $91.4 million to this improvement as a result of an operating profit of $56.2 million in 1986 compared with an operating loss of $35.2 million in 1985. The wood and wood products segment contributed $28.1 million to the recovery while the building materials segment remained unchanged from 1985.

The turnaround in the pulp and paper segment resulted partially from a significant improvement in pulp sales prices. In western Europe, for example, the price rose from about U.S. $390/tonne in the fourth quarter of 1985 to U.S. $520/tonne in the fourth quarter of 1986. Reduced manufacturing and transportation costs in conjunction with production and sales volume increases for both pulp and paper also contributed significantly to the turnaround.

The improvement in the wood and wood products segment was also partially attributable to higher sales prices since production and sales volumes were lower as a result of the strike by the International Woodworkers of America which affected Canfor's operations in British Columbia. In addition, reduced costs and higher productivity contributed to the improved results from this segment.

Sales in the building materials segment were lower in 1986 by $55.9 million. However, the effect of this was offset by higher margins and reduced costs, resulting in the same $3.2 million operating income as achieved in 1985.

The combination of lower borrowing levels as a result of substantially improved cash generation from operations, financing and divestment actions taken during the year and generally lower interest rates reduced interest expense by $11.7 million, a 30 per cent decrease from 1985.

Income from the oil and gas working interests acquired in 1985 amounted to $11.5 million in 1986, compared with $25.8 million in 1985. The working interests were repurchased by the seller during 1986.

### Changes in financial position

Cash generated from operating activities increased in 1986 to $111.8 million from $0.8 million in 1985. This was the result of the $119.8 million turnaround in operating results coupled with a $20.1 million reduction in cash employed in working capital and the $11.7 million reduction in interest expense. These items were partially offset by a provision for current income taxes $32.3 million higher than for 1985.

During 1986, an additional 3.8 million common shares were sold. Certain of these common shares entitled the purchaser to share purchase tax credits amounting to $6.5 million. The net proceeds of $56.8 million from this issue were applied to reduce short-term bank indebtedness.

Property, plant and equipment expenditures during 1986 amounted to $37.9 million which was $25.7 million lower than in 1985. The reduction in capital spending was a result of the completion during 1985 of the pulp machine replacement at Howe Sound Pulp Division and the continued restriction of capital spending to essential and high return projects.

The improved results for 1986 and the outlook for continuing improvement in 1987 provided the opportunity to apply investment tax credits amounting to $19.1 million, the majority of which Canfor had previously been unable to utilize.

Cash generation from the oil and gas working interests amounted to $27.1 million in 1986, compared with $9.8 million in 1985.

The Company realized $10.2 million from the sale of its 50.38 per cent interest in Balco Industries Ltd. In addition, Balco's $4.0 million of net short-term indebtedness and $5.9 million of long-term debt were removed from Canfor's accounts as a result of the divestiture.

## Financial position

The cash generated from operations plus the financing and investing activities during 1986 reduced Canfor's net short-term indebtedness by $116.2 million.

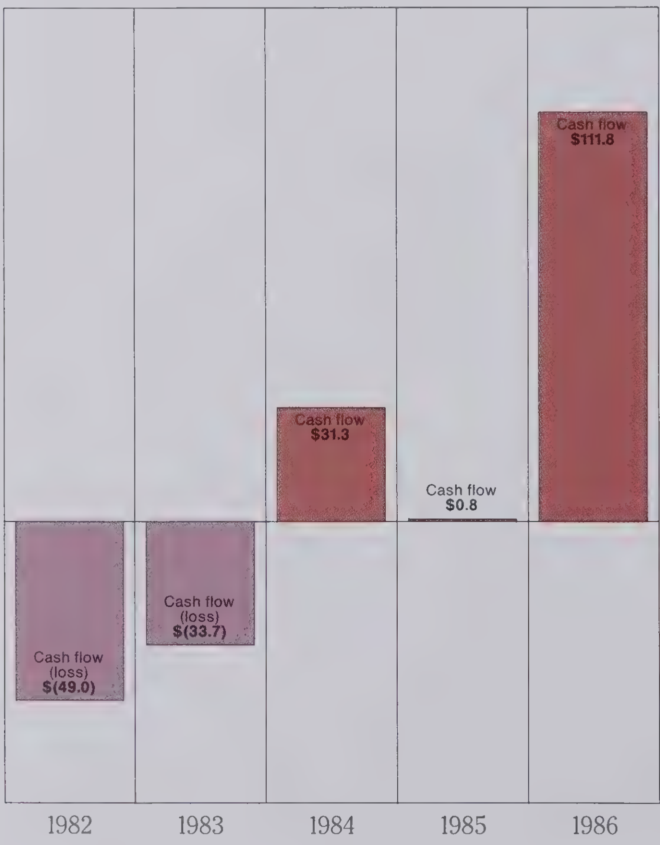
Working capital increased in 1986 from $1.3 million in 1985 to $61.7 million even after the transfer of $55 million to the collateral account as security for the Retractable Class A Preferred Shares. The ratio of current assets to current liabilities at the end of 1986 was 1.3:1, compared to a ratio of 1.0:1 for 1985.

Total interest-bearing debt at the end of 1986 amounted to $253.2 million, of which $78.2 million was current and $175 million was long-term. This compares to total debt at the end of 1985 of $432.6 million, of which $244.7 million was current and $187.9 million was long-term. Canfor's ratio of total debt to equity was 43:57 at the end of 1986 compared with a ratio of 60:40 at the end of 1985.


*A truckload of cement in kraft paper sacks leaves the Pan Malaysia Cement Works (S) Pte. Ltd. yard in Singapore. Canfor kraft paper is used by sack manufacturers around the world.*

Canfor's past levels of capital spending and cost reduction have positioned it to meet the current upswing in the market cycle with its physical plant in good repair. Capital spending in 1986 included a significant proportion committed to high return projects, as does the planned 1987 program. The increased cash flow expected from operations during 1987 will be applied to additional financially attractive capital expenditures and to continued debt reduction with the aim of further enhancing the Company's profitability.

Cash flow from operations
*$ millions*



# Summary of principal accounting policies *December 31, 1986*

## Basis of presentation of financial statements

These financial statements include the accounts of Canfor Corporation (the Company) and its subsidiary companies (Page 40), hereinafter referred to as "Canfor."

Canfor's investment in B.C. Chemicals Ltd., an affiliated company, is accounted for on the equity basis.

## Valuation of inventories

Inventories of wood products, pulp, sack kraft paper, building materials, logs and chips are valued at the lower of average cost and net realizable value. Processing materials and supplies are valued at the lower of average cost and replacement cost.

## Property, plant and equipment

Canfor capitalizes the costs of major replacements, extensions and improvements to plant and equipment, together with related interest expense incurred during the construction period.

Depreciation of logging and manufacturing assets is calculated on a unit of production basis.

Depreciation of plant and equipment not employed in logging and manufacturing is based on the estimated useful lives of the assets and is calculated on a straight-line basis.

Amortization of logging roads is dependent upon their nature and is calculated on either a straight-line basis or on the basis of the volume of timber removed.

Depletion of timber is calculated on the basis of the volume of timber removed.

## Deferred charges

Deferred financial costs are amortized over the lives of the related debt. Software development costs, relating to major systems, are deferred and amortized over periods not longer than ten years.

## Pension costs

Canfor has various contributory and non-contributory pension plans which cover most salaried employees and certain hourly employees not covered by forest industry-union pension plans.

Current service pension costs are charged to earnings as they accrue. Past service costs resulting from plan improvements are charged to earnings and funded at rates which, based on independent actuarial estimates, will provide for the obligation over periods not longer than fifteen years. Pension agreements with certain executives (some of whom are retired) who are not participants in Canfor's pension plans are not funded. Annual costs under these agreements are charged to earnings and the liabilities are included in other long-term liabilities.

## Foreign currency translation

Foreign currencies are translated into Canadian dollars using the temporal method as follows:

Monetary assets and liabilities at year-end or applicable hedged exchange rates; non-monetary assets and liabilities at historical rates; revenues and expenses at exchange rates prevailing at the time the transaction occurs.

Exchange gains or losses are reflected in income immediately with the exception of unrealized translation gains or losses related to long-term monetary liabilities hedged by future revenue streams, which are deferred until realized.

Canfor's foreign operations are considered to be self-sustaining and the assets and liabilities are translated using the current rate method. The translation gain or loss is included as a component of shareholders' equity.

## Income taxes

Canfor accounts for income taxes on the tax allocation method. Under this method, timing differences between reported and taxable income result in provisions for taxes not currently payable. Such timing differences arise principally as a result of claiming depreciation, depletion, amortization and deferred charges for tax purposes at amounts differing from those charged to income.

Investment tax credits are accounted for using the cost reduction method.

# Consolidated statement of income and earnings reinvested in the business *(in thousands of dollars)*

*Year ended December 31*

| | 1986 | 1985 |
|---|---|---|
| Net sales | $1,046,776 | $1,083,799 |
| Costs and expenses | | |
| Cost of products sold | 847,674 | 997,101 |
| Depreciation, depletion and amortization | 37,710 | 45,277 |
| Selling and administration | 65,168 | 64,986 |
| | 950,552 | 1,107,364 |
| Operating income (loss) | 96,224 | (23,565) |
| Interest expense *(Note 12)* | (27,526) | (39,260) |
| Other income (expense) | (197) | 3,730 |
| Oil and gas income *(Note 11)* | 11,484 | 25,760 |
| Income (loss) before income taxes | 79,985 | (33,335) |
| Income tax (expense) recovery *(Note 16)* | | |
| Current | (31,473) | 825 |
| Deferred | (21,357) | (21,556) |
| | (52,830) | (20,731) |
| Income (loss) before undernoted items | 27,155 | (54,066) |
| Equity in income (loss) of affiliated company | 60 | (8,183) |
| Minority interest in subsidiary | (1,166) | (282) |
| Income (loss) before extraordinary items | 26,049 | (62,531) |
| Extraordinary items *(Note 14)* | 5,992 | 1,077 |
| Net income (loss) before write-down | 32,041 | (61,454) |
| Write-down of investment in Versatile Corporation *(Note 3)* | (8,256) | — |
| Net income (loss) | $ 23,785 | $ (61,454) |
| Net income (loss) per common share (after provision for dividends on preferred shares) | | |
| Before extraordinary items and write-down | $ 0.92 | $ (3.73) |
| After extraordinary items before write-down | $ 1.21 | $ (3.67) |
| After extraordinary items and write-down | $ 0.81 | $ (3.67) |
| Earnings reinvested in the business at beginning of year | $ 19,984 | $ 88,168 |
| Net income (loss) for the year | 23,785 | (61,454) |
| Preferred share dividends | (6,715) | (6,730) |
| Share issue expenses | (2,096) | — |
| Earnings reinvested in the business at end of year *(Note 19)* | $ 34,958 | $ 19,984 |

## Consolidated cash flow statement *(in thousands of dollars)*

*Year ended December 31*

| | 1986 | 1985 *(Note 20)* |
|---|---|---|
| **Cash generated from (used in)** | | |
| **Operating activities** | | |
| Operating income (loss) | $ 96,224 | $ (23,565) |
| Depreciation, depletion and amortization | 37,710 | 45,277 |
| Proceeds on disposal of assets | 4,644 | 5,051 |
| Gain on disposal of assets | (5,442) | (1,483) |
| Working capital changes | 30,232 | 10,127 |
| Income tax (expense) recovery | (31,473) | 825 |
| Other | 7,470 | 3,795 |
| | 139,365 | 40,027 |
| Interest (net of capitalized portion) | (27,526) | (39,260) |
| | 111,839 | 767 |
| **Financing activities** | | |
| Long-term liabilities | (7,814) | (43,196) |
| Dividends paid by Canfor to preferred shareholders | (6,715) | (6,730) |
| Net proceeds on issue of common shares and sale of share purchase tax credits *(Note 9)* | 56,793 | — |
| | 42,264 | (49,926) |
| **Investing activities** | | |
| Property, plant and equipment | (37,926) | (63,631) |
| Investment tax credits applied *(Note 4)* | 19,101 | 4,131 |
| Extraordinary items *(Note 14)* | 14,291 | 50,651 |
| Oil and gas *(Note 11)* | 27,140 | 9,832 |
| Collateral account *(Note 9)* | (55,062) | — |
| Other | (9,517) | (5,303) |
| | (41,973) | (4,320) |
| **Decrease (increase) in net short-term indebtedness*** | 112,130 | (53,479) |
| **Elimination of a former subsidiary company's net short-term indebtedness** *(Note 14)* | 4,051 | — |
| **Net short-term indebtedness at beginning of year** | (190,979) | (137,500) |
| **Net short-term indebtedness at end of year** | $ (74,798) | $ (190,979) |
| **Operating working capital changes** | | |
| Accounts receivable | $ (3,646) | $ (1,395) |
| Inventories | 19,531 | 25,401 |
| Income taxes | 17,255 | (790) |
| Accounts payable | (2,908) | (13,089) |
| | $ 30,232 | $ 10,127 |

**Net short-term indebtedness consists of cash, temporary investments, unpresented cheques and bank loans.*

## Consolidated balance sheet *(in thousands of dollars)*

| December 31 | 1986 | 1985 |
|---|---|---|
| ASSETS | | |
| Current assets | | |
| Cash and temporary investments | $ 799 | $ 41,849 |
| Accounts receivable | | |
| Trade | 105,146 | 105,210 |
| Other | 16,699 | 29,621 |
| Affiliated company | — | 561 |
| Income taxes recoverable | — | 1,136 |
| Inventories *(Note 2)* | 168,628 | 198,768 |
| Oil and gas investment *(Note 11)* | — | 19,369 |
| Total current assets | 291,272 | 396,514 |
| Long-term investments *(Note 3)* | 66,027 | 22,545 |
| Property, plant and equipment *(Note 4)* | 411,473 | 443,794 |
| Timber *(Note 4)* | 9,346 | 10,802 |
| Other assets *(Note 5)* | 11,448 | 7,145 |
| Deferred charges *(Note 6)* | 27,480 | 33,958 |
| | $ 817,046 | $ 914,758 |

### Auditors' report

To the Shareholders of Canfor Corporation:

We have examined the consolidated balance sheet of Canfor Corporation as at December 31, 1986 and the consolidated statements of income and earnings reinvested in the business and cash flow for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Price Waterhouse

February 20, 1987
Chartered Accountants

*December 31*

| | 1986 | 1985 |
|---|---|---|
| LIABILITIES | | |
| Current liabilities | | |
| Bank loans and unpresented cheques *(Note 7)* | $ 75,597 | $ 232,828 |
| Accounts payable and accrued liabilities *(Note 18)* | 118,982 | 136,717 |
| Income taxes payable | 15,287 | — |
| Current portion of long-term debt *(Note 8)* | 18,857 | 24,815 |
| Dividends payable | 853 | 876 |
| Total current liabilities | 229,576 | 395,236 |
| Long-term liabilities | | |
| Long-term debt *(Note 8)* | 175,020 | 187,851 |
| Other liabilities | 11,169 | 10,948 |
| | 186,189 | 198,799 |
| Deferred income taxes | 41,828 | 20,473 |
| Minority interest in subsidiary | 232 | 8,272 |
| SHAREHOLDERS' EQUITY | | |
| Share capital *(Note 9)* | | |
| Preferred shares | 86,000 | 86,000 |
| Common shares | 237,775 | 185,386 |
| | 323,775 | 271,386 |
| Earnings reinvested in the business *(Note 19)* | 34,958 | 19,984 |
| Foreign exchange translation adjustment | 488 | 608 |
| | 359,221 | 291,978 |
| Commitments and contingent liabilities *(Note 15)* | | |
| | $ 817,046 | $ 914,758 |

APPROVED BY THE BOARD

Peter J. G. Bentley, Director

Ronald L. Cliff, Director

# Notes to consolidated financial statements *December 31, 1986*

## 1. Accounting policies

The principal accounting policies followed by Canfor are summarized under the caption "Summary of principal accounting policies."

## 2. Inventories

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| Wood products, pulp, sack kraft paper and building materials | $ 99,822 | $119,243 |
| Logs and chips | 42,362 | 52,163 |
| Processing materials and supplies | 26,444 | 27,362 |
| | $168,628 | $198,768 |

## 3. Long-term investments

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| 50% interest in B.C. Chemicals Ltd. at cost plus equity in undistributed net income since acquisition | $ 3,250 | $ 3,191 |
| 50% partnership interest in Balco Reforestation Centre (1985–100%) | 783 | 2,016 |
| 2,778,000 Class A subordinate voting shares of Versatile Corporation (1986 at market value, 1985 at cost, market value $11,400,000)* | 3,334 | 11,590 |
| Cash and short-term investments, at cost, pledged as security under a standby credit agreement (Note 9) (market value—$55,062,000) | 55,062 | — |
| Deposits and other investments, at cost | 3,598 | 5,748 |
| | $ 66,027 | $ 22,545 |

**The Company wrote down its investment in Versatile Corporation to the market value of the shares at February 17, 1987.*

## 4. Property, plant and equipment and timber

Property, plant and equipment

| | Cost | Accumulated depreciation | Net book value |
|---|---|---|---|
| | | ($000's) | |
| *December 31, 1986* | | | |
| Land | $ 12,097 | $ — | $ 12,097 |
| Pulp and paper mills | 473,526 | 209,892 | 263,634 |
| Sawmills, plywood, hardboard and shingle mills | 219,792 | 131,400 | 88,392 |
| Logging buildings and equipment | 40,168 | 30,268 | 9,900 |
| Logging roads and bridges | 64,089 | 48,169 | 15,920 |
| Other equipment and facilities | 43,480 | 21,950 | 21,530 |
| | $853,152 | $441,679 | $411,473 |

Investment tax credits in the amount of $19,101,000 earned in the years 1981 to 1983 and 1986 have been credited to plant and equipment in 1986 and are being amortized on the same basis as the related assets.

| | Cost | Accumulated depreciation | Net book value |
|---|---|---|---|
| | | ($000's) | |
| *December 31, 1985* | | | |
| Land | $ 14,864 | $ — | $ 14,864 |
| Pulp and paper mills | 466,807 | 191,490 | 275,317 |
| Sawmills, plywood, hardboard and shingle mills | 238,633 | 141,974 | 96,659 |
| Logging buildings and equipment | 46,097 | 34,636 | 11,461 |
| Logging roads and bridges | 64,033 | 47,335 | 16,698 |
| Other equipment and facilities | 60,509 | 31,714 | 28,795 |
| | $890,943 | $447,149 | $443,794 |

| Timber | Cost | Accumulated depletion | Net book value |
|---|---|---|---|
| | | ($000's) | |
| December 31, 1986 | $ 26,098 | $ 16,752 | $ 9,346 |
| December 31, 1985 | $ 27,217 | $ 16,415 | $ 10,802 |

## 5. Other assets

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| Contract receivable | $ 2,750 | $ 3,006 |
| Future income taxes recoverable | 8,698 | 3,979 |
| Advances receivable—affiliated company | — | 160 |
| | $ 11,448 | $ 7,145 |

## 6. Deferred charges

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| Unrealized foreign exchange losses on long-term debt | $ 21,271 | $ 26,884 |
| Software development costs | 5,523 | 6,195 |
| Debt issue and other expenses | 686 | 879 |
| | $ 27,480 | $ 33,958 |

## 7. Bank loans and unpresented cheques

Operating bank loans of $75,597,000 (1985—$232,828,000), including unpresented cheques of $16,277,000 (1985—$12,893,000) are, with the exception of a $16,507,000 loan, secured by a general assignment of accounts receivable and hypothecation of inventories. In addition, $42,813,000 is secured by a floating charge on all the assets of a subsidiary company. The lines of credit arranged under the terms of the loans were $218,423,000 (1985—$244,788,000).

## 8. Long-term debt

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| **Canfor Corporation** | | |
| The Prudential Insurance Company of America, $36,900,000 U.S. note payable, interest at 8.875% repayable in instalments in the years 1987–1998 | $ 50,759 | $ 55,499 |
| Chemical Bank, $5,000,000 U.S. note payable, repaid during 1986 | — | 7,008 |
| $50,000,000 U.S. note agreement with a Canadian bank, interest at a rate related to the U.S. dollar London Interbank rate for U.S. dollar deposits (LIBOR) ranging to a maximum of LIBOR plus ⅞%, repayable in instalments in the years 1988–1992 | 68,780 | 70,075 |
| | 119,539 | 132,582 |
| **Prince George Pulp and Paper Limited** | | |
| Agreement payable—repayable in instalments in the years 1987–1989, interest at 7.25% | 5,963 | — |
| Term loan agreement in U.S. dollars, with two Canadian banks, interest at a rate related to LIBOR ranging to a maximum of LIBOR plus 1%, repayable in instalments in the years 1987–1992 ($39,063,000 U.S.) | 53,954 | 61,293 |
| | 59,917 | 61,293 |
| **Balco Industries Ltd.** | | |
| Promissory note and bank loan | — | 5,912 |
| **Takla Forest Products** | | |
| Bank loan, repaid during 1986 | — | 2,400 |
| **Westcoast Cellufibre Industries Ltd.** | | |
| Bank loan, repaid during 1986 | — | 2,000 |
| **Canfor U.S.A. Corporation** | | |
| Bank loan, interest at U.S. bank prime plus ¼%, repayable in instalments in the years 1987–1990 ($2,945,000 U.S.) | 4,051 | 5,158 |
| Other notes payable and capital leases, repayable in the years 1987–1991 | 10,370 | 3,321 |
| | 193,877 | 212,666 |
| Less: Current portion of long-term debt | | |
| Bank loans | 11,803 | 12,703 |
| Notes and agreements payable | 5,294 | 11,724 |
| Amounts due on capitalized equipment leases | 1,760 | 388 |
| | 18,857 | 24,815 |
| | $175,020 | $187,851 |

The bank loans are secured by general assignments of accounts receivable and hypothecation of inventories. In addition, $68,780,000 is secured by a floating charge on all the assets of a subsidiary company.

The agreement relative to The Prudential Insurance Company of America contains provisions limiting the amount of indebtedness which the Company and designated subsidiaries can incur and limiting the amount of cash dividends on common shares to $34,928,000 at December 31, 1986.

The note agreement and the term loan agreement include provisions limiting the amount of indebtedness which may be incurred.

Repayments on long-term debt required in each of the next five years are as follows

| | ($000's) |
|---|---|
| 1987 | $18,857 |
| 1988 | $29,979 |
| 1989 | $31,942 |
| 1990 | $28,420 |
| 1991 | $28,471 |

## 9. Share capital

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| **Canfor Corporation** | | |
| *Authorized* | | |
| 110,000 7% cumulative, redeemable non-voting preferred shares, with a par value of $100 each | | |
| 10,000,000 Class A non-voting preferred shares, with a par value of $25 each, of which | | |
| 1,000,000 of such Class A preferred shares are designated $2.25 cumulative redeemable exchangeable Class A preferred shares, Series 1 | | |
| 2,000,000 of such Class A preferred shares are designated floating rate cumulative redeemable retractable Class A preferred shares, Series 2 | | |
| 50,000,000 common shares without par value | | |
| *Issued* | | |
| 110,000 7% preferred shares | $ 11,000 | $ 11,000 |
| 1,000,000 Class A preferred shares, Series 1 | 25,000 | 25,000 |
| 2,000,000 Class A preferred shares, Series 2 | 50,000 | 50,000 |
| 22,390,265 common shares (1985—18,575,475) | 237,775 | 185,386 |
| | 323,775 | 271,386 |
| Preferred shares issued to subsidiary company | (50,000) | (50,000) |
| **Canfor Capital Limited** | | |
| *Issued* | | |
| 2,000,000 senior preferred shares, Series 1 | 50,000 | 50,000 |
| | $323,775 | $271,386 |

9. Share capital (continued)

7% preferred shares

The 7% preferred shares rank on a parity with the Class A preferred shares and are entitled to preference over the common shares with respect to the payment of cumulative dividends at the rate of 7% per annum. So long as any 7% preferred shares are outstanding the Company may not, without the approval of the holder of the 7% preferred shares given by special resolution, redeem or purchase any common shares.

Class A preferred shares

The Class A preferred shares rank on a parity with the 7% preferred shares and are entitled to preference over the common shares with respect to the payment of dividends.

Exchangeable Class A preferred shares

The exchangeable preferred shares entitle the holders at any time prior to the close of business on June 30, 1991 or the third business day prior to the date fixed for redemption, whichever is earlier, to acquire from Canfor 2.778 Class A subordinate voting shares of Versatile Corporation, which is equivalent to an exchange price of $9.00 per Class A subordinate voting share.

On and after July 1, 1987 and prior to July 1, 1989, the exchangeable preferred shares are redeemable at $26.00 per share if the Class A subordinate voting shares of Versatile Corporation have traded on a designated stock exchange for a specified period at a weighted average price of not less than 125% of the exchange price. On and after July 1, 1989, the exchangeable preferred shares are redeemable at $26.00 per share declining by $0.25 annually to $25.00 on and after July 1, 1993, in each case plus accrued and unpaid dividends.

During each calendar quarter and commencing in the first full calendar quarter following the expiry of the exchange privilege, the Company will make all reasonable efforts to purchase for cancellation, at a price not exceeding $25.00 per share plus costs of purchase, 1% of the number of exchangeable preferred shares outstanding on the expiry of the exchange privilege. This obligation is cumulative within each calendar year.

The exchangeable preferred shares carry a right to cumulative preferred cash dividends at a rate of $2.25 per share per annum.

Retractable Class A preferred shares

In 1984, the Company issued 2,000,000 floating rate cumulative redeemable retractable Class A preferred shares, Series 2, at a price of $25.00 per share, to a wholly-owned subsidiary, Canfor Capital Limited. Concurrently, Canfor Capital Limited made a public issue of 2,000,000 floating rate senior preferred shares at a price of $25.00 per share. The proceeds of this issue were used to purchase the floating rate preferred shares of Canfor Corporation.

In conjunction with the Canfor Capital Limited issue, a support agreement was entered into among Canfor Capital Limited, Canfor Investments Ltd., a Canadian chartered bank, and the Royal Trust Company in which the bank unconditionally covenants to ensure that all obligations of Canfor Capital Limited to holders of the floating rate preferred shares are met under conditions in which redemption is required. The commitment of the bank will expire on November 30, 1991 if all dividends, retraction and redemption obligations to that date have been met.

Also, a standby credit agreement was entered into among Canfor Capital Limited, Canfor Investments Ltd., and a Canadian chartered bank, with respect to the repayment, on demand, of any funds loaned by the bank under the support agreement. Cash and temporary investments in the amount of $55,062,000 is held in a cash collateral account (Note 3) under the agreement.

Common shares

The holders of the common shares have no pre-emptive, redemption or conversion rights.

During 1986, 3,800,000 common shares were offered for sale. Certain of these common shares were entitled to share purchase tax credits. Net proceeds after expenses amounted to $56,793,000.

10. Senior management stock option plan

The Company has established a Senior Management Stock Option Plan for officers and certain employees of Canfor. Under this plan, the Company has reserved for issue 700,000 common shares of which options on 521,950 were outstanding at December 31, 1986 (1985—460,000). The exercise price for these options is between $9.00 and $16.00 per share with expiry dates from March 1990 to July 1994. In 1986, 14,790 common shares were issued under this plan. No options were exercised in 1985.

11. Oil and gas

The working interests in the oil and gas properties acquired in 1985 have been repurchased by the sellers in 1986.

The results from these working interests are as follows

| | 1986 | 1985 ($000's) | Total |
|---|---|---|---|
| Income from oil and gas activities | $ 11,484 | $ 25,760 | $ 37,244 |
| Depletion | 17,119 | 63,831 | 80,950 |
| Working capital changes | (3,713) | 3,441 | (272) |
| | 24,890 | 93,032 | 117,922 |
| Proceeds on sale of working interests | 2,250 | — | 2,250 |
| Debt repayments | — | (83,200) | (83,200) |
| Cash flow from oil and gas | $ 27,140 | $ 9,832 | $ 36,972 |

## 12. Interest expense

Long-term and short-term interest expense, net of interest income and capitalized interest, amounted to $16,140,000 (1985—$20,730,000) and $11,386,000 (1985—$18,530,000) respectively.

## 13. Unfunded pension and retirement accruals

Canadian Forest Products Ltd. has pension agreements with certain executives, the liability for which is accrued but not funded. The total accrued liability, based on an actuarial valuation as at December 1985 and an estimation for 1986, is $6,334,000 (1985—$6,224,000).

Canadian Forest Products Ltd. and Canfor Limited also have unfunded accrued liabilities of $686,000 in respect of retirement allowances at December 31, 1986 (1985 – $944,000).

Canfor's other pension plans are funded. Based on actuarial valuations conducted during 1986, there was an estimated net accrued surplus of $4,200,000 at December 31, 1986 (1985—$5,439,000). Accrued surpluses were used to fund the companies' current service costs, which for 1986 amounted to $3,200,000 (1985—$3,166,000).

## 14. Extraordinary items

| | Gain (loss) | | Cash from (used in) | |
|---|---|---|---|---|
| | 1986 | 1985 | 1986 | 1985 |
| | ($000's) | | | |
| Income tax reduction resulting from the application of prior years' losses | $ 5,497 | $ — | $ — | $ — |
| Sale of land and warehouses (net of tax of $384,000) | 1,233 | 3,681 | 2,544 | 7,871 |
| Sale of long-term investments (net of tax recovery of $38,000) | (963) | 1,110 | — | 44,007 |
| Sale of 50.38% interest in Balco Industries Ltd. (a former subsidiary company) (net of tax of $1,444,000) | (551) | — | 10,230 | — |
| Insurance claim on dry kiln (net of tax of $264,000) | 292 | — | 595 | — |
| Plant closure (net of tax of $438,000) | 484 | (3,714) | 922 | (1,227) |
| | $ 5,992 | $ 1,077 | $ 14,291 | $ 50,651 |

## 15. Commitments and contingent liabilities

(a) The future minimum lease payments under capital and operating leases are as follows

| | Capital leases | Operating leases |
|---|---|---|
| | ($000's) | |
| 1987 | $ 2,703 | $ 4,308 |
| 1988 | 2,665 | 3,614 |
| 1989 | 3,801 | 3,027 |
| 1990 | 1,511 | 2,463 |
| 1991 | 1,862 | 2,158 |
| Thereafter | — | 8,898 |
| Total minimum lease payments | 12,542 | $ 24,468 |
| Less amount representing imputed interest at rates ranging from 9.25% to 12.75% | 2,612 | |
| Present value of obligations under capital leases | 9,930 | |
| Due within one year | 1,760 | |
| Long-term obligations under capital leases | $ 8,170 | |

(b) Canfor has contracted for the use of railway cars for a stipulated sum before mileage allowances. As a result of mileage allowances earned in 1986 and 1985, the cost to Canfor under this contract was not significant. Commitments in respect of this contract, before mileage allowances, are as follows

| | ($000's) |
|---|---|
| 1987 | $3,530 |
| 1988 | $3,316 |
| 1989 | $3,092 |
| 1990 | $2,191 |
| 1991 | $ 844 |

## 16. Income taxes

Investment tax credits of $8,698,000 are available to reduce future income taxes payable and losses of $121,355,000 are available to reduce future taxable income as follows

| Available for deduction | Investment tax credits | Losses Canada | Losses U.S. | Losses Total |
|---|---|---|---|---|
| | ($000's) | | | |
| 1987 | $ 6,949 | $ — | $ — | $ — |
| 1988 | 929 | — | — | — |
| 1990 | — | 55,010 | — | 55,010 |
| 1991 | — | 23,409 | — | 23,409 |
| 1993 | 820 | — | — | — |
| 1995 and thereafter | — | — | 42,936 | 42,936 |
| | $ 8,698 | $ 78,419 | $ 42,936 | $121,355 |

### 16. Income taxes (continued)

At December 31, 1986 depreciation included in the above losses is less than the amounts which can be claimed for income tax purposes by $85,875,000 which, together with the loss carry-forwards, are available to reduce future taxable income.

Capital losses of $380,000 are available to reduce capital gains in future years.

The potential income tax benefits associated with the capital losses and the U.S. tax losses have not been recorded in Canfor's accounts.

The components of Canfor's income tax (expense) recovery for 1986 and 1985 are as follows

| | 1986 | 1985 |
|---|---|---|
| | ($000's) | |
| Income (loss) before income taxes | **$ 79,985** | $ (33,335) |
| Tax (expense) recovery at Canadian federal income tax rate of 46% | **$(36,793)** | $ 15,335 |
| Canadian manufacturing and processing allowance | **3,710** | (1,801) |
| Surtax on federal taxes | **(1,295)** | — |
| Provincial income taxes | **(4,555)** | 1,753 |
| Items not deductible for tax purposes | **(2,802)** | (2,561) |
| Inventory allowances | **322** | 2,617 |
| Recognition of tax losses of prior years | **8,993** | 10,987 |
| Oil and gas expenditures not allowed for tax purposes | **(20,027)** | (47,061) |
| Capital losses not deductible | **(383)** | — |
| Income tax (expense) | **$(52,830)** | $ (20,731) |
| Effective tax rate | **64.9%** | 62.2% |

### 17. Segmented information

Information relating to Canfor's business on a segmented basis is set out in the Statement of segmented information.

### 18. Related party transactions

Certain directors, private companies controlled by such directors and individuals, have periodically loaned funds to Canfor repayable on demand and bearing interest at the prime rate less 1%. During 1986, the maximum and minimum loaned to Canfor under this arrangement were $18,436,000 and $14,504,000 respectively. At December 31, 1986 these loans amounted to $16,219,000 (1985—$16,689,000) and were included in accounts payable and accrued liabilities.

### 19. Contributed surplus

During 1979, Canadian Forest Products Ltd. purchased for cancellation its outstanding 25,389 5% non-cumulative redeemable preferred shares of $100 par value at $10 per share which resulted in a gain of $2,285,000 which is included in earnings reinvested in the business.

### 20. Comparative figures

Certain 1985 comparative figures have been restated to conform with the 1986 presentation.

SUBSIDIARY COMPANIES

*Active*

*Wholly-owned*

Canadian Forest Products Ltd.(1)
Canadian Forest Products S.A.
Canadian Forest Products Overseas Limited
Canfor Limited
Canfor Capital Limited
Canfor Investments Ltd.
Canfor Japan Corporation
Canfor Properties Ltd.
Canfor Pulp Sales Ltd.
Canfor U.S.A. Corporation
Prince George Pulp and Paper Limited(2)

*Partially-owned*

Westcoast Cellufibre Industries Ltd. (92.5%)

*Partnership*

Balco Reforestation Centre (50%)

*Inactive (including holding companies not carrying on active operations)*

British Columbia Shingles Limited
Canadian Forest Products Sales Ltd.
Canfor Investments Holdings Ltd.
CFP Investments Ltd.
Eburne Saw Mills Limited
Howe Sound Pulp Company Ltd.
Howe Sound Transportation Company Limited
North Canadian Forest Products (1981) Limited
Pacific Veneer Company Limited

(1) *The Takla Forest Products partnership was dissolved on December 31, 1985 and the assets and liabilities were acquired by Canadian Forest Products Ltd. on January 1, 1986.*

(2) *Intercontinental Pulp Company Ltd. was amalgamated with Prince George Pulp and Paper Limited on December 26, 1986.*

## Statement of segmented information *Years ended December 31, 1986 and 1985 (in millions of dollars)*

| | Wood and wood products | | Pulp and paper | | Building materials | | Consolidated | |
|---|---|---|---|---|---|---|---|---|
| | 1986 | 1985 | 1986 | 1985 | 1986 | 1985 | 1986 | 1985 |
| **By industry segment** | | | | | | | | |
| Net sales | | | | | | | | |
| To external customers | $ 241.3 | $ 287.8 | $ 319.7 | $ 254.3 | $ 485.8 | $ 541.7 | $1,046.8 | $1,083.8 |
| To other segments | 110.4 | 168.2 | — | — | — | — | | |
| | $ 351.7 | $ 456.0 | $ 319.7 | $ 254.3 | $ 485.8 | $ 541.7 | | |
| Operating income (loss) | $ 49.1 | $ 21.0 | $ 56.2 | $ (35.2) | $ 3.2 | $ 3.2 | $ 108.5 | $ (11.0) |
| Non segment expenses—net | | | | | | | (84.8) | (50.4) |
| Net income (loss) | | | | | | | $ 23.7 | $ (61.4) |
| Identifiable assets | $ 241.5 | $ 277.3 | $ 394.8 | $ 405.6 | $ 99.8 | $ 107.3 | $ 736.1 | $ 790.2 |
| Corporate assets and investments | | | | | | | 80.9 | 124.6 |
| Total assets | | | | | | | $ 817.0 | $ 914.8 |
| Depreciation, depletion and amortization | $ 18.8 | $ 25.4 | $ 18.2 | $ 16.5 | $ 2.3 | $ 2.4 | | |
| Capital expenditures | $ 19.4 | $ 24.6 | $ 13.9 | $ 32.0 | $ 1.7 | $ 2.5 | | |

| | Canada | | United States | | Consolidated | |
|---|---|---|---|---|---|---|
| | 1986 | 1985 | 1986 | 1985 | 1986 | 1985 |
| **By geographic segment** | | | | | | |
| Net sales | | | | | | |
| To external customers | $ 877.5 | $ 863.8 | $ 169.3 | $ 220.0 | $1,046.8 | $1,083.8 |
| To other segments | 9.0 | 20.5 | | | | |
| Operating income (loss) | 112.2 | (8.4) | (3.7) | (2.6) | 108.5 | (11.0) |
| Identifiable assets | 702.0 | 750.0 | 34.1 | 40.2 | 736.1 | 790.2 |
| Depreciation, depletion and amortization | 38.4 | 43.1 | 0.9 | 1.2 | | |
| Capital expenditures | 34.5 | 57.5 | 0.5 | 1.6 | | |

*1. Canfor operates in three industry segments: wood and wood products, pulp and paper, building materials.*
*2. Sales to other segments are accounted for at prices which approximate market.*
*3. Canadian sales include export sales amounting to $527 million in 1986 (1985–$468 million).*

# Eight year comparative review

| Sales and income *(in millions of dollars)* | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 | 1980 | 1979 |
|---|---|---|---|---|---|---|---|---|
| Net sales | $1,046.8 | $1,083.8 | $1,029.5 | $ 995.1 | $ 729.6 | $ 710.5 | $ 730.1 | $ 734.0 |
| Cost of products sold | 847.7 | 997.1 | 908.4 | 881.3 | 700.5 | 615.9 | 564.7 | 522.3 |
| Depreciation, depletion and amortization | 37.7 | 45.3 | 45.1 | 48.6 | 45.0 | 39.1 | 34.8 | 32.7 |
| Selling and administration | 65.2 | 65.0 | 62.7 | 62.7 | 66.8 | 51.4 | 46.7 | 42.2 |
| Interest expense | 27.5 | 39.2 | 44.2 | 49.0 | 50.4 | 31.4 | 16.6 | 16.1 |
| Other (income) expense | (11.3) | (29.5) | (2.9) | (0.4) | 0.8 | (0.9) | (1.6) | — |
| Income (loss) before income taxes | 80.0 | (33.3) | (28.0) | (46.1) | (133.9) | (26.4) | 68.9 | 120.7 |
| Income tax (expense) recovery | (52.8) | (20.7) | 3.1 | 9.9 | 46.0 | 8.1 | (30.9) | (53.3) |
| Income (loss) before undernoted items | 27.2 | (54.0) | (24.9) | (36.2) | (87.9) | (18.3) | 38.0 | 67.4 |
| Equity in income (loss) of affiliated companies | — | (8.2) | 1.4 | (9.3) | (2.5) | 20.2 | 17.1 | 13.1 |
| Minority interests in subsidiaries | (1.2) | (0.3) | 2.3 | 1.0 | 5.9 | (1.5) | (5.0) | (5.9) |
| Income (loss) before extraordinary items | 26.0 | (62.5) | (21.2) | (44.5) | (84.5) | 0.4 | 50.1 | 74.6 |
| Extraordinary items | 6.0 | 1.1 | (2.6) | 0.3 | — | 2.8 | (0.8) | 1.9 |
| Net income (loss) before write-down | 32.0 | (61.4) | (23.8) | (44.2) | (84.5) | 3.2 | 49.3 | 76.5 |
| Write-down of investment in Versatile Corporation | (8.3) | — | — | — | — | — | — | — |
| Net income (loss) | 23.7 | (61.4) | (23.8) | (44.2) | (84.5) | 3.2 | 49.3 | 76.5 |
| Preferred share dividends | (6.7) | (6.7) | (3.3) | (0.9) | (0.9) | (0.8) | (0.8) | (0.8) |
| Net income (loss) for common shareholders | $ 17.0 | $ (68.1) | $ (27.1) | $ (45.1) | $ (85.4) | $ 2.4 | $ 48.5 | $ 75.7 |
| **Assets and capitalization** *(in millions of dollars)* | | | | | | | | |
| Working capital | $ 61.7 | $ 1.3 | $ 48.5 | $ 26.1 | $ (118.6) | $ 5.0 | $ 142.5 | $ 135.2 |
| Long-term investments | 66.0 | 22.5 | 73.1 | 73.9 | 84.9 | 88.6 | 71.2 | 54.4 |
| Plant and equipment | 420.8 | 454.6 | 448.7 | 451.6 | 479.5 | 423.6 | 313.3 | 300.2 |
| Other assets and deferred charges | 38.9 | 41.1 | 30.8 | 18.6 | 20.4 | 16.7 | 9.8 | 6.5 |
| Net assets | $ 587.4 | $ 519.5 | $ 601.1 | $ 570.2 | $ 466.2 | $ 533.9 | $ 536.8 | $ 496.3 |
| Long-term liabilities | $ 186.2 | $ 198.8 | $ 231.0 | $ 242.3 | $ 223.6 | $ 161.5 | $ 163.6 | $ 172.3 |
| Deferred income taxes | 41.8 | 20.5 | 0.6 | 1.6 | 15.5 | 60.7 | 64.4 | 64.7 |
| Minority interests in subsidiaries | 0.2 | 8.2 | 9.8 | 12.1 | 16.8 | 23.4 | 22.9 | 19.6 |
| Preferred share capital | 86.0 | 86.0 | 86.0 | 11.0 | 18.5 | 11.0 | 11.0 | 11.0 |
| Common shareholders' equity | 273.2 | 206.0 | 273.7 | 303.2 | 191.8 | 277.3 | 274.9 | 228.7 |
| Total capitalization | $ 587.4 | $ 519.5 | $ 601.1 | $ 570.2 | $ 466.2 | $ 533.9 | $ 536.8 | $ 496.3 |
| **Additions to property, plant and equipment** *(in millions of dollars)* | $ 37.9 | $ 63.6 | $ 41.0 | $ 22.6 | $ 102.4 | $ 84.9 | $ 49.4 | $ 47.6 |

*NOTES:*

*(a) Certain 1985 comparative figures have been reclassified to conform with the 1986 presentation.*

*(b) Percentages reflect the results of Swanson Lumber Co. Ltd. and Canfor U.S.A. Corporation (formerly Chandler Corporation) from August 1, 1981, and December 1, 1981, respectively.*

| Cash generated from (used in) *(in millions of dollars)* | 1986 | 1985 | 1984 | 1983 | 1982 | 1981 | 1980 | 1979 |
|---|---|---|---|---|---|---|---|---|
| Operating activities | $ 111.8 | $ 0.8 | $ 31.3 | $ (33.7) | $ (49.0) | $ (26.8) | $ (5.9) | $ 114.9 |
| Financing activities | | | | | | | | |
| Long-term liabilities | (7.8) | (43.2) | (14.2) | 17.8 | 65.2 | (8.1) | (6.1) | (12.2) |
| Common and preferred shares | 56.8 | — | 72.5 | 145.6 | 7.6 | — | — | — |
| Dividends paid | (6.7) | (6.8) | (3.3) | (1.2) | (1.4) | (1.6) | (2.3) | (2.2) |
| | 42.3 | (50.0) | 55.0 | 162.2 | 71.4 | (9.7) | (8.4) | (14.4) |
| Investing activities | | | | | | | | |
| Property, plant and equipment | (37.9) | (63.6)(a) | (41.0) | (22.6) | (102.4) | (84.9) | (49.4) | (47.6) |
| Dividends received | — | — | 1.1 | 1.5 | 3.2 | 3.5 | 2.3 | 1.5 |
| Extraordinary items | 14.3 | 50.7 | (2.6) | — | — | 1.3 | (1.0) | 6.2 |
| Investment in subsidiaries | — | — | — | — | — | (61.3) | (1.7) | (1.5) |
| Other | (18.4) | 8.6(a) | (2.1) | (1.4) | (3.2) | 1.0 | (2.2) | (0.6) |
| | (42.0) | (4.3) | (44.6) | (22.5) | (102.4) | (140.4) | (52.0) | (42.0) |
| Decrease (increase) in net short-term indebtedness | $ 112.1 | $ (53.5) | $ 41.7 | $ 106.0 | $ (80.0) | $ (176.9) | $ (66.3) | $ 58.5 |
| **Financial statistics** | | | | | | | | |
| Return on capital employed—% | 5.5 | (5.5) | (0.1) | (2.5) | (7.8) | 3.0 | 11.2 | 18.7 |
| Return on common shareholders' equity—% | 7.1 | (28.5) | (9.3) | (18.2) | (36.4) | 0.9 | 19.4 | 40.0 |
| Ratio of current assets to current liabilities | 1.3:1 | 1.0:1 | 1.2:1 | 1.1:1 | 0.7:1 | 1.0:1 | 2.0:1 | 2.0:1 |
| Ratio of total debt to shareholders' equity | 43:57 | 60:40 | 52:48 | 58:42 | 71:29 | 57:43 | 42:58 | 44:56 |
| **Production and other statistics** | | | | | | | | |
| Pulp—thousands of metric tons | 515.8 | 509.8 | 456.8 | 493.2 | 441.5 | 418.5 | 526.0 | 499.7 |
| Sack kraft paper—thousands of metric tons | 101.1 | 89.7 | 80.0 | 85.0 | 88.5 | 77.7 | 97.0 | 96.6 |
| Lumber—millions of board feet | 989.6 | 1,308.7 | 1,223.3 | 1,164.6 | 768.2 | 711.4 | 749.5 | 783.7 |
| Plywood—millions of square feet 3/8 inch equivalent | 109.2 | 281.0 | 293.3 | 298.3 | 223.0 | 283.1 | 307.2 | 364.6 |
| Hardboard—millions of square feet 3/8 inch equivalent | 35.2 | 55.9 | 56.9 | 57.5 | 43.0 | 54.9 | 58.3 | 58.1 |
| Shingles and shakes—thousands of squares | 108.6 | 117.4 | 102.9 | 127.3 | 144.1 | 180.7 | 252.7 | 299.8 |
| **Sales by product line—% (b)** | | | | | | | | |
| Pulp and sack kraft paper | 30% | 24% | 25% | 24% | 33% | 39% | 43% | 35% |
| Lumber | 23 | 27 | 26 | 28 | 19 | 18 | 20 | 25 |
| Plywood and hardboard | 4 | 7 | 7 | 8 | 8 | 11 | 11 | 12 |
| Shingles and shakes | 1 | 1 | 1 | 1 | 1 | 2 | 2 | 3 |
| Building materials purchased for resale | 41 | 39 | 39 | 38 | 38 | 28 | 21 | 23 |
| Miscellaneous | 1 | 2 | 2 | 1 | 1 | 2 | 3 | 2 |
| | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |
| **Sales by market—% (b)** | | | | | | | | |
| Canada | 33% | 37% | 35% | 35% | 37% | 45% | 40% | 41% |
| United States | 39 | 41 | 40 | 43 | 34 | 20 | 21 | 26 |
| Europe | 15 | 11 | 13 | 12 | 19 | 21 | 24 | 22 |
| Far East | 9 | 9 | 8 | 7 | 8 | 11 | 12 | 9 |
| Other | 4 | 2 | 4 | 3 | 2 | 3 | 3 | 2 |
| | 100% | 100% | 100% | 100% | 100% | 100% | 100% | 100% |

*For definitions of selected financial terms, please refer to page 45*

# Manufacturing and marketing facilities†

## Principal manufacturing facilities and annual capacities

| PULP AND PAPER | THOUSAND TONNES |
|---|---|
| *Howe Sound Pulp Division* | |
| Port Mellon, B.C. | |
| KRAFT PULP | 215 |
| *Prince George Pulp and Paper* | |
| Prince George, B.C. | |
| KRAFT PULP | 170 |
| SACK KRAFT PAPER | 100 |
| *Intercontinental Pulp* | |
| Prince George, B.C. | |
| KRAFT PULP | 230 |
| | 715 |

| LUMBER | MILLION BOARD FEET |
|---|---|
| *Eburne Saw Mills Division* | |
| Vancouver, B.C. | 150 |
| *Westcoast Cellufibre Industries Ltd.* | |
| Vancouver, B.C. | 55 |
| *Fort St. James Division* | |
| Fort St. James, B.C. | 185 |
| *Isle Pierre Division* | |
| Isle Pierre, B.C. | 90 |
| *Chetwynd Division* | |
| Chetwynd, B.C. | 145 |
| *Fort St. John Division* | |
| Fort St. John, B.C. | 125 |
| *Alberta Operations* | |
| Grande Prairie, Alberta | 130 |
| High Level, Alberta | 215 |
| Hines Creek, Alberta | 60 |
| | 1155 |

| PANEL PRODUCTS | MILLION SQUARE FEET 3/8 INCH EQUIVALENT |
|---|---|
| *New Westminster Hardboard Division* | |
| New Westminster, B.C. | |
| HARDBOARD | 60 |
| *Alberta Operations* | |
| Grande Prairie, Alberta | |
| PLYWOOD | 65 |
| | 125 |

| SHINGLES | THOUSAND ROOF SQUARES |
|---|---|
| *Huntting-Merritt Shingle Division* | |
| Vancouver, B.C. | |
| SHINGLES | 135 |

### OTHER

Canfor's United States subsidiary, Canfor U.S.A. Corporation, produces remanufactured lumber items in Meridian, Idaho.

NOTE:
Pulp and paper capacities are based on continuous operation for 344 days per year. Hardboard capacity is based on continuous operation for 345 days per year. Capacities for other wood products assume 240 operating days per year and two shifts per day except for the Huntting-Merritt and Westcoast Cellufibre capacities which reflect one shift per day and three shifts per day, respectively. In many cases, the capacities differ from previously published figures because of changes in mill facilities, log supply and product mix.

†As at March 6, 1987

## Sales and Distribution Facilities

### PULP AND PAPER SALES OFFICES

Vancouver, B.C.
Montreal, Quebec
London, England
Brussels, Belgium
Tokyo, Japan

In addition, Canfor is represented by pulp and paper sales agents serving other major markets around the world.

### LUMBER AND SHINGLE SALES OFFICE

Vancouver, B.C.

### WATERBORNE WOOD PRODUCTS SALES

Sales of lumber, panel products, shingles and shakes to markets reached by ship are made through Seaboard Lumber Sales Company Limited, a worldwide wood products marketing consortium of which Canfor is a member.

### WHOLESALE BUILDING MATERIALS DISTRIBUTION CENTRES—CANADA

*Western Region*
Burnaby, B.C.
Kelowna, B.C.
Nanaimo, B.C.
Calgary, Alberta
Edmonton, Alberta
Grande Prairie, Alberta
Saskatoon, Saskatchewan
Winnipeg, Manitoba

*Central Region*
Toronto, Ontario
London, Ontario
North Bay, Ontario
Ottawa, Ontario
Peterborough, Ontario
Montreal, Quebec
Quebec City, Quebec

*Atlantic Region*
Dartmouth, Nova Scotia
Sydney, Nova Scotia
Fredericton, New Brunswick
Moncton, New Brunswick
Deer Lake, Newfoundland
St. John's, Newfoundland

LUMBER SALES AND DISTRIBUTION FACILITIES —UNITED STATES
Meridian, Idaho
Bedford, New Hampshire

*Net income per common share* is the net income for the year, less provision for preferred dividends in the year, divided by the weighted average number of common shares outstanding during the year.

*Cash flow from operations per common share* is the cash flow from operations for the year, less provision for preferred dividends in the year, divided by the weighted average number of common shares outstanding during the year.

*Common shareholders' equity per common share* is the shareholders' equity excluding preferred share capital at the end of the year, divided by the common shares outstanding at the end of the year.

*Total capitalization* is comprised of long-term liabilities, deferred income taxes, minority interest in subsidiary and shareholders' equity.

*Capital employed* consists of the funds invested or retained in the Company in the form of shares or liabilities. It is composed of unpresented cheques, current bank loans (net of cash and temporary investments), current portion of long-term debt, long-term debt, deferred income taxes, minority interest in subsidiary and shareholders' equity. Long-term liabilities such as deferred reforestation costs and unfunded pension and retirement benefits are specifically excluded because they do not represent borrowed funds or funds invested by shareholders.

*Return on capital employed* is equal to net income plus interest, after tax, divided by the average of the capital employed as at the beginning and end of the year.

*Return on common shareholders' equity* is equal to net income for the year, less provision for preferred dividends in the year, divided by the average of the shareholders' equity excluding preferred share capital at the beginning and end of the year.

*Number of employees at year-end* is the actual number of employees, salaried and hourly, full-time and part-time, permanent and temporary, who are considered as employees of the Company. This includes employees who are on vacation, leave of absence, workers' compensation, long-term disability or who are laid off as the result of temporary shut down.

# Corporate information†

## Directors

*(Left to right, seated) Ron Cliff, Peter Bentley, Bill Daniel;*
*(Left to right, standing) Gordon Armstrong, Peter Lusztig, Mark Gunther, Roy Bickell, Ron Mannix, Joe Jarvis.*

A. Gordon Armstrong, Q.C. (1,2)
*Senior Vice-President, Finance*
*Canfor Corporation*
*Vancouver, B.C.*

Peter J. G. Bentley, O.C. (1,3)
*Chairman and Chief Executive Officer*
*Canfor Corporation*
*Vancouver, B.C.*

Roy A. Bickell (1)
*President and Chief Operating Officer*
*Canfor Corporation*
*Vancouver, B.C.*

Ronald L. Cliff, C.M. (1,2,3)
*Chairman of the Board*
*Inland Natural Gas Co. Ltd.*
*Vancouver, B.C.*

C. William Daniel, O.C.
*Corporate Director/Consultant*
*Toronto, Ontario*

Mark H. Gunther (1,3)
*Vice-Chairman*
*Canfor Corporation*
*Vancouver, B.C.*

Joseph B. Jarvis (1)
*Corporate Director*
*Vancouver, B.C.*

Peter A. Lusztig (2)
*Dean, Faculty of Commerce and Business Administration*
*University of British Columbia*
*Vancouver, B.C.*

Ronald N. Mannix
*Chairman*
*Manalta Coal Ltd.*
*Calgary, Alberta*

John G. Prentice, O.C. (1)
*Co-founder*
*Canfor Corporation*
*Vancouver, B.C.*

### Committees of the Board

(1) Executive Committee
(2) Audit Committee
(3) Compensation Committee

†As at December 31, 1986

## Officers

Peter J. G. Bentley, O.C.
*Chairman and Chief Executive Officer*

Mark H. Gunther
*Vice-Chairman*

Roy A. Bickell
*President and Chief Operating Officer*

A. Gordon Armstrong, Q.C.
*Senior Vice-President, Finance*

Peter J. Ashby
*Vice-President, Wood Products Marketing, Sales and Transportation*

Douglas C. Edwards
*Vice-President, Human Resources*

J. Derek Falck
*Vice-President, Corporate Services*

W. Bert Gayle
*Vice-President, Wood Products, B.C. Operations*

G. Brian Hobson
*Vice-President and Corporate Controller*

William I. Hughes
*Vice-President, Pulp and Paper Manufacturing*

Wayne B. Jacques
*Vice-President, Alberta Operations*

Richard F. Weinman
*Vice-President and Secretary*

Ray B. Haslam
*Deputy Corporate Controller*

## Auditors

Price Waterhouse
Vancouver, B.C.

## Head office

3000 – Four Bentall Centre
1055 Dunsmuir Street
Vancouver, B.C.
Telephone: (604) 661-5241
Telex: 04-53338

## Postal address

2800 – 1055 Dunsmuir Street
Post Office Box 49420
Bentall Postal Station
Vancouver, B.C., Canada
V7X 1B5

## Principal wholly-owned subsidiaries

Canadian Forest Products Ltd.
Canfor Limited
Canfor U.S.A. Corporation
Prince George Pulp and Paper Limited

## Interest in other companies

B.C. Chemicals Ltd. (50%)
Westcoast Cellufibre Industries Ltd. (92.5%)

# Shareholder information

## Annual general meeting

The annual general meeting of the shareholders of the Company will be held in the Park Ballroom, Four Seasons Hotel, 791 West Georgia Street, Vancouver, B.C. on Monday, April 27, 1987, at 11:00 a.m.

## Transfer agent and registrar

The Royal Trust Company
Vancouver, Calgary, Regina, Winnipeg, Toronto, Montreal and Halifax.

## Shares listed

Toronto Stock Exchange
(common and preferred shares)
Vancouver Stock Exchange
(common shares only)
Symbol: CFP

## 1986 price range of common shares

High: $17 1/8 per share
Low: $ 9 1/4 per share

## Number of common shares outstanding

22,390,265 shares,
as at December 31, 1986

## Number of common shareholders

930 shareholders,
as at December 31, 1986

*At Canfor, we use our customers' products whenever we can. This year, we are pleased to present our annual report on Centura Dull cover and Centura Dull text, fine quality products from Consolidated Papers, Inc. of Wisconsin Rapids, Wisconsin, U.S.A.*

Canfor Corporation

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